[JOINT COMMITTEE PRINT]

SUMMARY OF CONFERENCE AGREEMENT ON H.R. 3838 (TAX REFORM ACT OF 1986)

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

AUGUST 29, 1986

U.S. GOVERNMENT PRINTING OFFICE

63-115 O WASHINGTON : 1986 JCS-16-86

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, DC 20402

J862-39

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INTRODUCTION

This pamphlet[1] provides a title-by-title summary of the principal provisions of H.R. 3838 (Tax Reform Act of 1986), as agreed to by the House-Senate Conferees on August 16, 1986. As a general rule, this pamphlet does not describe agreements of the Conferees not to adopt a particular provision that was only in the House-passed bill or only in the Senate-passed bill, i.e., agreements to retain present law on particular issues.

This pamphlet is provided for the use of the Members of the House and the Senate. The official legislative document on the conference decisions on H.R. 3838 will be the conference report on the bill (including the Statement of Managers explaining the conference decisions).

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Summary of Conference Agreement on H.R. 3838 (Tax Reform Act of 1986)* (JCS-16-86), August 29, 1986

SUMMARY OF THE CONFERENCE AGREEMENT

Title I. Individual Income Tax Provisions

A. Basic Rate Structure

1. Tax rate schedules

New schedules.—The conference agreement provides two-bracket rate schedules for individual taxpayers, with rates of 15 and 28 percent. This new structure replaces the present-law structure of up to 15 brackets, with a top rate of 50 percent. The new structure goes into effect beginning in 1988; transitional rate schedules are provided for 1987 returns.

The 28-percent rate begins at taxable income levels of $29,750 for married individuals filing jointly and surviving spouses, $23,900 for heads of household, $17,850 for single individuals, and $14,875 for married individuals filing separately. (Taxable income equals adjusted gross income less personal exemptions and less the standard deduction or itemized deductions.) Beginning in 1989, the taxable income amounts at which the 28-percent rate starts will be adjusted for inflation.

Rate adjustment.—Beginning in 1988, the benefit of the 15-percent bracket is phased out for taxpayers having taxable income exceeding specified levels. The income tax liability of such taxpayers is increased by five percent of their taxable income within specified ranges.

The rate adjustment occurs between $71,900 and $149,250 of taxable income for married individuals filing jointly; between $61,650 and $123,790 of taxable income for heads of household; between $43,150 and $89,560 of taxable income for single individuals; and between $35,950 and $113,300 of taxable income for married individuals filing separately. These amounts will be adjusted for inflation beginning in 1989.

The maximum amount of the rate adjustment generally equals 13 percent of the maximum amount of taxable income within the 15-percent bracket applicable to the taxpayer (for a married individual filing separately, within the 15-percent bracket applicable for married taxpayers filing jointly). Thus, if the maximum rate adjustment applies, the 28-percent rate in effect applies to all of the taxpayer's taxable income, rather than only to the amount of taxable income above the breakpoint.

Transitional rate structure for 1987.—For taxable years beginning in 1987, five-bracket rate schedules are provided, as shown in the table below. Neither the rate adjustment (described above) nor the personal exemption phaseout (described below) applies for 1987.

Tax rate	Taxable income brackets		
	Married, filing joint returns	Heads of household	Singles
11%	0–$3,000	0–$2,500	0–$1,800
15%	3,000–28,000	2,500–23,000	1,800–16,800
28%	28,000–45,000	23,000–38,000	16,800–27,000
35%	45,000–90,000	38,000–80,000	27,000–54,000
38.5%	Above 90,000	Above 80,000	Above 54,000

For married individuals filing separate returns, the taxable income bracket amounts for 1987 begin at one-half the amounts for joint returns.

2. Standard deduction

Increased amounts for all taxpayers.—Under the conference agreement, the standard deduction replaces the zero bracket amount (ZBA). Effective in 1988, the standard deduction amounts are $5,000 for married individuals filing jointly and for surviving spouses; $4,400 for heads of household; $3,000 for single individuals; and $2,500 for married individuals filing separately. Beginning in 1989, these amounts will be adjusted for inflation.

Additional amount for the elderly or blind.—An additional standard deduction amount of $600 is allowed for an elderly or blind individual who is married ($1,200 for a married individual who is both elderly and blind). An additional standard deduction amount of $750 is allowed for an unmarried individual who is elderly or blind ($1,500 if both). For elderly or blind taxpayers only, the new standard deduction amounts (listed in the preceding paragraph) and the additional $600 or $750 standard deduction amounts are effective beginning in 1987. Beginning in 1989, the $600 and $750 additional standard deduction amounts will be adjusted for inflation.

Standard deduction for 1987.—For all individual taxpayers other than elderly or blind individuals, the standard deduction amounts for 1987 are $3,800 for married individuals filing jointly and surviving spouses; $2,570 for heads of household and single individuals; and $1,900 for married individuals filing separately.

3. Personal exemption

Exemption amount.—The conference agreement increases the personal exemption for each individual, the individual's spouse, and each dependent to $1,900 for 1987, $1,950 for 1988, and $2,000 in 1989. Beginning in 1990, the $2,000 personal exemption amount will be adjusted for inflation.

Beginning in 1988, the personal exemption amounts are phased out for taxpayers having taxable income exceeding specified levels. The income tax liability of such taxpayers is increased by five percent of taxable income within certain ranges. This reduction in the personal exemption amounts starts at the taxable income level at which the benefit of 15-percent rate is totally phased out (see "Rate adjustment," above). For example, in the case of married individuals filing joint returns, in 1988 the personal exemption phaseout

begins at taxable income of $149,250. The exemption is totally phased out at $10,920 per exemption above that amount in 1988 and $11,200 per exemption above that amount in 1989. For example, in the case of married individuals filing jointly who have two dependent children, in 1988 the four $1,950 personal exemptions are completely phased out at taxable income of $192,930.

Relief for elderly.—The additional personal exemptions in present law for the elderly and for blind individuals are repealed, starting in 1987. As stated above, the conference agreement provides an additional standard deduction amount of $600 or $750 for an elderly or blind individual, starting in 1987. In addition, the increased standard deduction amounts generally applicable in 1988 (e.g., $5,000 for married individuals filing jointly) apply for elderly or blind individuals starting in 1987. The present-law tax credit for the elderly and certain disabled individuals is retained.

Rules for dependents.—The conference agreement provides that the personal exemption is not allowed to an individual who is eligible to be claimed as a dependent on another taxpayer's return (for example, where a child is eligible to be claimed as a dependent on his or her parents' return). This rule is intended to preclude the doubling of tax benefits allowed under present law, where the personal exemption for a child can be claimed by the parents on their return and also by the child on his or her return. However, unlike the present-law rule that allows such dependent to use the standard deduction (ZBA) only to offset earned income, the conference agreement provides that the dependent may use up to $500 of his or her standard deduction to offset unearned income. These rules for dependents are effective beginning in 1987.

4. Inflation adjustments

Inflation adjustments (indexing) to the rate brackets, standard deduction (and the $600 or $750 additional standard deduction), and personal exemption will be made beginning in the years stated above. These adjustments will be rounded down to the nearest multiple of $50. The 12-month period for measuring inflation will end August 31 (rather than September 30) of each year.

5. Repeal of two-earner deduction

The deduction for two-earner married individuals is repealed, beginning in 1987. Adjustments made in the standard deduction for married individuals filing jointly and in the relationship of the rate schedules for unmarried individuals and married individuals filing joint returns are intended to compensate for the repeal of this provision.

6. Repeal of income averaging

The conference agreement repeals income averaging, beginning in 1987, in light of the new rate structure.

B. Earned Income Credit

The conference agreement increases the refundable earned income credit from 11 percent of the first $5,000 of earned income to 14 percent of the first $5,714 of earned income, beginning in 1987. (The earned income credit provides tax relief to low-income

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working individuals with children.) Thus, the maximum credit is increased from $550 to $800. In addition, the conference agreement increases the credit phase-out to apply at higher income levels ($9,000–$17,000) than under present law, effective beginning in 1988.

As a further liberalization of present law, the maximum dollar amount of earned income against which the credit applies ($5,714) and the income levels at which the phase-out of the credit begins ($6,500 in 1987 and $9,000 in 1988 and later years) are to be adjusted, beginning in 1987, for inflation occurring after 1984. These adjustments will not be subject to the $50 rounding-down rule otherwise applicable under the conference agreement to inflation adjustments.

Under the conference agreement, Treasury regulations are to require employers to notify employees whose wages are not subject to income tax withholding that they may be eligible for the refundable earned income credit.

C. Exclusions From Income

1. Unemployment compensation benefits

The present-law partial exclusion for unemployment compensation benefits is repealed, effective beginning in 1987.

2. Scholarships and fellowships

Under the conference agreement, the exclusion for scholarship or fellowship grants is limited to degree candidates, and to amounts required to be used for tuition and course-required fees, books, supplies, and equipment; thus, additional amounts for room, board, or incidental expenses are not excludable. No exclusion is provided for nondegree candidates.

The conference agreement also provides that the exclusion does not apply to any portion of amounts received as a grant or a tuition reduction that represents payment for teaching, research, or other services required as a condition of receiving the grant, or to certain Federal grants where the recipient is required to perform future services as a Federal employee.

These provisions are effective for scholarships and fellowships granted after August 16, 1986.

3. Prizes and awards

Under the conference agreement, the present-law exclusion for certain prizes and awards for charitable, scientific, artistic, and similar achievements is to apply only if the winner assigns the prize or award to charity. The conference agreement provides a limited exclusion for certain employee awards for length of service or safety achievement; all other prizes or awards by employers to employees are includible in income except for de minimis fringe benefits excludable under Code section 132(e). These provisions are effective beginning in 1987.

D. Deductions for Personal Expenditures

1. Itemized deduction for State and local sales taxes

The itemized deduction for State and local sales taxes is repealed, effective beginning in 1987. The itemized deductions for State and local income taxes, real estate taxes, and personal property taxes are retained.

The conference agreement also provides that State, local, and foreign taxes for which an itemized deduction is not allowed, but which are incurred in a business or investment activity in connection with the acquisition or disposition of property, are not deductible; instead, such taxes are to be treated as part of the cost of the acquired property or as a reduction in the amount realized on the disposition. This provision is effective for taxable years beginning on or after January 1, 1987.

2. Charitable deduction for nonitemizers

Under the conference agreement, the nonitemizer charitable deduction terminates for contributions made after December 31, 1986, as under present law.

3. Medical expense deduction

The floor under the medical expense deduction is increased from five percent to 7.5 percent of the taxpayer's adjusted gross income, effective beginning in 1987. The conference agreement clarifies that certain expenses incurred to accommodate a personal residence to the needs of a physically handicapped individual are eligible for the medical expense deduction.

4. Adoption expenses

The itemized deduction for certain costs of adopting special needs children is repealed, effective beginning in 1987. Also, the conference agreement modifies the Adoption Assistance Program of Title IV-E of the Social Security Act to provide assistance through that program for such adoption expenses.

5. Deductibility of mortgage interest and taxes allocable to certain housing allowances

The conference agreement provides that the receipt of tax-free housing allowances by ministers or military personnel does not result in loss of deductions for mortgage interest or real property taxes on the individual's residence, effective for past and future years.

E. Expenses for Business or Investment

1. Meals, travel, and entertainment expenses

Under the conference agreement, 80 percent of otherwise allowable business meal expenses and business entertainment expenses are deductible, subject to certain exceptions (including qualified banquet meeting meals) allowing full deductibility. The requirements for deducting business meal expenses are tightened, generally by conformity to the standards for deducting other business entertainment expenses.

No deductions are allowed for (1) any costs of attending conventions or seminars other than for trade or business purposes, (2) educational travel expenses, (3) charitable travel expenses unless there is no significant element of personal pleasure, recreation, or vacation in the travel, or (4) costs (other than 80 percent of regular ticket costs) of renting skyboxes for more than one event (subject to a three-year phase-in of skybox nondeductibility). Deductions for entertainment ticket costs and luxury water travel are limited. The conference agreement also tightens certain rules with respect to home office expenses and hobby losses.

These provisions are effective for taxable years beginning on or after January 1, 1987.

2. Employee business expenses, investment expenses, and other miscellaneous itemized deductions

Under the conference agreement, employee business expenses other than reimbursed expenses (sec. 62(2)(A)) are to be allowed only as itemized deductions and are subject to the floor described below. Moving expenses of an employee or self-employed individual are to be allowed only as itemized deductions, but are not subject to the new floor.

The miscellaneous itemized deductions, including the employee business expenses described above, generally are subject to a floor of two percent of the taxpayer's adjusted gross income. However, the floor does not apply to impairment-related work expenses for handicapped employees; estate tax in the case of income in respect to a decedent; certain adjustments where a taxpayer restores amounts held under a claim of right; amortizable bond premium; certain costs of cooperative housing corporations; expenses of short sales in the nature of interest; certain terminated annuity payments; and gambling losses to the extent of gambling winnings. The floor is to apply with respect to indirect deductions through pass-through entities (including mutual funds) other than estates, trusts, cooperatives, and REITs.

Under the conference agreement, a new above-the-line deduction is allowed for business expenses of certain performing artists who had more than one employer during the taxable year, whose allowable expenses in performing such services exceed 10 percent of wages for such services, and whose adjusted gross income (before deducting such expenses) does not exceed $16,000.

These provisions are effective for taxable years beginning on or after January 1, 1987.

F. Political Contributions Tax Credit

The conference agreement repeals the tax credit for political contributions, effective beginning in 1987.

Title II. Capital Cost Provisions

A. Cost Recovery: Depreciation; ITC; Finance Leases

1. Depreciation and expensing

Accelerated Cost Recovery System

The conference agreement modifies the Accelerated Cost Recovery System (ACRS) for property placed in service after December 31, 1986, except for property covered by transition rules. The cost of property placed in service after July 31, 1986, which is not transition-rule property, may be covered under the modified rules at the election of the taxpayer.

The conference agreement provides more accelerated depreciation for the revised three-year, five-year, and ten-year classes and reclassifies certain assets according to their present class life (or "ADR midpoint life"), including the creation of a seven-year and twenty-year class. Depreciation methods are prescribed for each ACRS class (in lieu of providing statutory tables). Eligible personal property is assigned among a three-year class, a five-year class, a seven-year class, a ten-year class, a fifteen-year class, or a twenty-year class.

The depreciation method applicable to property included in the three-year, five-year, seven-year, and ten-year classes is the double declining balance method, switching to the straight-line method at a time to maximize the depreciation allowance. For property in the fifteen-year and twenty-year class, the conference agreement applies the 150-percent declining balance method, switching to the straight-line method at a time to maximize the depreciation allowance. The cost of real property is recovered using the straight-line method over 27.5 years for residential rental property and 31.5 years for nonresidential real property.

Property is classified into the classes as follows:

Three-year class.—ADR midpoints of four years and less, except excludes automobiles and light trucks, and includes horses in the present-law three-year class.

Five-year class.—ADR midpoints of more than four years and less than 10 years, and adding automobiles, light trucks, qualified technological equipment, computer-based central office switching equipment, renewable energy and biomass properties that are small power production facilities, and research and experimentation property.

Seven-year class.—ADR midpoints of 10 years and more and less than 16 years, adding single-purpose agricultural or horticultural structures and property with no ADR midpoint not classified elsewhere.

Ten-year class.—ADR midpoints of 16 years and more and less than 20 years.

Fifteen-year class.—ADR midpoints of 20 years and more and less than 25 years, including waste-water treatment plants, and telephone distribution plant and comparable equipment used for the two-way exchange of voice and data communications.

Twenty-year class.—ADR midpoints of 25 years and more, other than real property with an ADR midpoint of 27.5 years and more, and including sewer pipes.

27.5-year class.—Residential rental property.

31.5-year class.—Nonresidential real property (real property that is not residential rental property and that either has no ADR midpoint, or the ADR midpoint of which is not less than 27.5 years).

Alternative Depreciation System

A taxpayer may elect to recover the cost of property over the ACRS class life or, generally, the ADR midpoint life, using the straight-line method. For purposes of computing the depreciation preference under the minimum tax, the cost of personal property is recovered using the 150-percent declining balance method, switching to the straight-line method, generally over the ADR midpoint life. Additionally, assets used abroad or by tax-exempt entities, or financed with the proceeds of tax-exempt bonds, and for purposes of computing earnings and profits must be recovered using the straight-line method generally over the ADR midpoint life.

Expensing

The amount of personal property that may be expensed is increased to $10,000 (from the present-law $5000). For every dollar of qualifying investment in excess of $200,000, the $10,000 limit is reduced by one dollar.

2. Regular investment tax credit

The conference agreement repeals the investment tax credit for property placed in service after December 31, 1985, except for property covered by transition rules. Investment tax credits on transition property result in a full basis adjustment. Beginning in 1988, credits on transition property and credit carryovers are subject to a 35-percent reduction (17.5 percent in 1987).

3. Finance leasing

Finance leasing is repealed for agreements entered into after December 31, 1986, except for property covered by transition rules.

B. Limit on General Business Credit

The conference agreement reduces the 85-percent limitation on the amount of income tax liability that can be offset by business tax credits to 75 percent, for taxable years beginning after December 31, 1985. Credits subject to the limitation include the research credit and the low-income housing credit.

C. Research and Development

1. Tax credit for increasing research expenditures

The conference agreement extends the incremental research tax credit for an additional three years, i.e., for qualified research ex-

penditures paid or incurred through December 31, 1988. In addition, the conference agreement modifies the credit as follows:

(a) The credit rate is reduced from 25 percent to 20 percent.

(b) Rental and similar payments for the use of personal property in research are made ineligible for the credit, except for certain payments for use of computer time.

(c) The definition of qualified research for purposes of the credit is modified.

(d) Increased tax incentives are provided for corporate cash expenditures in excess of certain floors for basic research performed by universities or certain scientific research organizations.

(e) The general limitation on use of business credits is applied to the research credit.

The provision extending the research credit is effective for taxable years ending after December 31, 1985, with respect to expenditures prior to January 1, 1989. The provisions modifying the credit are effective for taxable years beginning after December 31, 1985, except that the modifications to the university basic research credit are effective for taxable years beginning after December 31, 1986.

2. Augmented charitable deduction for donations of scientific equipment

The present-law rule allowing an augmented charitable deduction for donations of newly manufactured scientific equipment to universities for research use is extended to such donations made to certain tax-exempt scientific research organizations, effective for taxable years beginning after December 31, 1985.

3. Tax credit for orphan drug clinical testing

The tax credit for clinical testing of orphan drugs is extended for three additional years, i.e., through December 31, 1990.

D. Rapid Amortization Provisions

1. Trademark and trade name expenditures

The conference agreement repeals five-year amortization for trademarks and tradenames, for expenditures paid or incurred after December 31, 1986. Transitional rules are provided for certain binding contracts.

2. Railroad grading and tunnel bores

The conference agreement repeals 50-year amortization for qualified railroad grading and tunnel bores, for expenditures paid or incurred after December 31, 1986. Transitional rules are provided for certain binding contracts.

3. Bus operating authorities

Owners of certain bus operating authorities are allowed an ordinary deduction ratably over five years for loss in value of such authorities, effective for taxable years ending after November 18, 1982. A similar rule will apply to freight forwarders, contingent on deregulation.

4. Removal of architectural and transportation barriers to the handicapped and elderly

The conference agreement makes permanent the election to deduct up to $35,000 of qualifying expenditures for removing architectural and transportation barriers to the handicapped and elderly, effective for taxable years beginning after December 31, 1985.

E. Real Estate Provisions

1. Tax credit for rehabilitation expenditures

The conference agreement replaces the existing three-tier rehabilitation credit with a two-tier credit for qualified rehabilitation expenditures. The credit percentage is 10 percent for expenditures incurred in rehabilitation of buildings (other than certified historic structures) built before 1936, and 20 percent for certified historic structures.

In general, the conference agreement retains the structure of the existing rehabilitation credit, except that the external walls requirement is modified in the case of certified historic structures. In addition, the conference agreement requires a basis adjustment for the full amount of the rehabilitation credit in the case of both historic and nonhistoric buildings.

For a summary of the rules applicable with respect to the credit under the passive loss limitations of the conference agreement, see Title V.B., below.

The modifications to the rehabilitation credit generally are applicable to property placed in service after December 31, 1986.

2. Tax credit for low-income rental housing

The conference agreement provides a new tax credit that may be claimed by owners of residential rental property providing low-income housing. This new tax credit replaces existing tax incentives for low-income housing—i.e., preferential depreciation, five-year amortization of rehabilitation expenditures, and special treatment of construction period interest and taxes. Separate credits are provided for new construction and rehabilitation of low-income housing and for certain costs of acquisition of existing housing to serve low-income individuals.

The credits are claimed annually for a period of 10 years. The annual credit has a maximum rate for property placed in service in 1987 of nine percent for new construction and rehabilitation, and a maximum rate of four percent for the acquisition cost of existing housing. (These credit rates are equivalent to a credit with a present value of 70 percent and 30 percent, respectively.) All credits apply only to the expenditures on the low-income units. In addition, in order to qualify for the credit for new construction or rehabilitation, such expenditures must exceed $2,000 per low-income unit. Certain costs of new construction and rehabilitation of low-income housing financed with tax-exempt bonds or receiving other Federal subsidies are eligible for a credit having a present value of 30 percent (i.e., for property placed in service in 1987, four percent each year for 10 years).

Residential rental property is eligible for the credit if either (1) at least 20 percent of the housing units in the project are occupied

by individuals with incomes of 50 percent or less of area median income, or (2) at least 40 percent of the housing units in the project are occupied by individuals with incomes of 60 percent or less of area median income. Income limits are adjusted for family size and may be adjusted for areas with unusually low family income or high housing costs relative to family income. The rent charged to tenants in units with respect to which the credit is allowable may not exceed 30 percent of the qualifying income. Eligible projects must continuously comply with these requirements for a 15-year period. The penalty for noncompliance is recapture of prior credits. Certain single room occupancy housing is eligible for the credit.

Each State is permitted to issue low-income rental housing tax credits in an annual amount equal to $1.25 per resident of the State. At least 10 percent of this credit authority must be reserved for projects developed by certain nonprofit organizations, one of whose exempt purposes is the fostering of low-income housing. This credit authority is sufficient to cover approximately $14 per capita of new construction or rehabilitation expenditures (for property not receiving other Federal subsidies) or $31 per capita of acquisition cost. Additionally, expenditures financed with the proceeds of tax-exempt bonds are eligible for the credit without reducing a State's credit authority, since the volume of these bonds is directly limited under the conference agreement.

The basis with respect to which credits are allowed must be reduced by the amount of any rehabilitation credit under section 46 for which the property is eligible. The basis of a project for depreciation is not reduced by the amount of low-income housing tax credits claimed.

For a summary of the rules applicable with respect to the credit under the passive loss limitations of the conference agreement, see Title V.B., below. For purposes of the credit, a limited exception to the credit at-risk rules is provided.

The credit is effective for property placed in service after December 31, 1986, and before January 1, 1990. Property placed in service after 1989 may qualify for the credit if expenditures of 10 percent or more of total project costs are incurred before January 1, 1989, and the property is placed in service before January 1, 1991.

F. Merchant Marine Capital Construction Fund

The Merchant Marine Act of 1936, as amended, provides Federal income tax incentives for U.S. taxpayers who own or lease vessels operated in the foreign or domestic commerce of the United States or in U.S. fisheries. The conference agreement coordinates the application of the Internal Revenue Code of 1986 with the capital construction fund program of the Merchant Marine Act of 1936, as amended. In addition, new requirements are imposed relating to (1) the tax treatment of nonqualified withdrawals, (2) certain reports to be made to the Secretary of the Treasury by the Secretaries of Transportation and Commerce, and (3) a 25-year time limit on the amount of time monies can remain in a fund without being withdrawn for a qualified purpose, effective for taxable years beginning after December 31, 1986.

Title III. Capital Gains and Losses

A. Individual Capital Gains

The conference agreement repeals the present-law exclusion for long-term capital gains of individuals, effective for taxable years beginning on or after January 1, 1987. Thus, such gains will be taxed at the same rates as ordinary income. However, the tax rate on long-term capital gains during calendar year 1987 will not exceed 28 percent. Capital losses are allowed in full against capital gains plus $3,000 of other income.

The present-law rules for nonrecognition of gain on sale of a principal residence where reinvested in a new residence, and for a one-time exclusion of up to $125,000 of gain on sale of a principal residence by a taxpayer age 55 or older, are retained.

B. Corporate Capital Gains

The alternative tax rate for net capital gains of corporations shall not apply for gain included in income in taxable years when the new corporate rates are fully effective (i.e., years beginning on or after July 1, 1987). For gain included in income in earlier taxable years but after December 31, 1986, the alternative tax rate is 34 percent. As under present law, capital losses are allowed in full against capital gains.

C. Incentive Stock Options

The conference agreement liberalizes the incentive stock option provisions by repealing the requirement that options must be exercised in the order granted, and modifies the $100,000 limit on the amount of options that may be granted in any year. Under this modification, an employer may not, in the aggregate, grant an employee incentive stock options that are first exercisable during any one calendar year to the extent that the aggregate fair market value of the stock (at the time the options are granted) exceeds $100,000. These provisions apply to options granted after December 31, 1986.

D. Straddles

Under the loss deferral rule in the straddle provisions, the conference agreement denies the qualified covered call exception to a taxpayer who fails to hold an option for 30 days after the related stock is disposed of at a loss, where gain on termination or other disposition of the option is included in the subsequent year. This provision applies to positions established after December 31, 1986.

Title IV. Agriculture, Timber, Energy, and Natural Resources

A. Agricultural Provisions

1. Special expensing provisions

The conference agreement provides that soil and water conservation expenditures are deductible only if they relate to improvements that are consistent with a conservation plan approved by the the U.S. Department of Agriculture or, if there is no Federally approved plan in the location of the land on which improvements are made, by a comparable State agency. In no event, however, may expenditures relating to the draining or filling of wetlands or the installation or operation of a center pivot irrigation system be deducted under this provision. This provision applies to expenditures after December 31, 1986.

The special provision allowing a deduction for land clearing expenditures is repealed, effective for expenditures after December 31, 1985. The special election to expense fertilizer and soil conditioning expenditures is retained.

2. Dispositions of converted wetlands and highly erodible croplands

The conference agreement provides that gain from the disposition of wetlands and highly erodible cropland that are converted to agricultural use (other than livestock grazing) is ordinary and that any loss on such disposition is a capital loss. The provision is effective for dispositions of land converted after March 1, 1986.

3. Preproductive period expenses of farmers

In general.—The conference agreement provides that the uniform capitalization rules (see VIII.D., below) apply to farmers in the case of products having a preproductive period of more than two years. Under a special election, certain farmers may elect to deduct preproductive period expenses currently, provided the alternative cost recovery system is used on all farm assets. The provision is effective for taxable years beginning after December 31, 1986.

Grove, orchard, and vineyard crops.—The conference agreement provides that planting and maintenance costs incurred following loss or damage to a grove, orchard, or vineyard as a result of freezing temperatures, disease, drought, pests, or casualty may be deducted by persons other than the farmer who owned the grove, etc., at the time the damage occurred, provided that (1) the taxpayer who owned the property at such time retains an equity interest of more than 50 percent in the property, and (2) the person claiming the deduction owns part of the remaining equity interest and materially participates in the planting or maintenance of the property. In addition, replanting costs may qualify even though the grove, etc. is replanted in a different location, provided the costs do not

relate to acreage in excess of the acreage of the property on which the loss or damage occurred. This provision is effective for such costs paid or incurred after the date of enactment.

4. Prepayments of farming expenses

The conference agreement provides that to the extent the prepaid farming expenses of a farmer using the cash method of accounting exceed 50 percent of total nonprepaid farm expenses, amounts paid for feed, seed, fertilizer, and certain other similar farm items may be deducted only as such items are actually consumed. This provision applies to amounts with respect to which a deduction otherwise would be allowable under present law after March 1, 1986.

5. Treatment of discharge of indebtedness income for certain farmers

The conference agreement provides that discharge of indebtedness income arising from an agreement between a solvent individual debtor engaged in the trade or business of farming and an unrelated person to discharge certain farming indebtedness is treated as income realized by an insolvent individual, and hence is eligible for exclusion from income if certain conditions are satisfied. Qualified indebtedness includes debt incurred to finance production of agricultural products and business debt secured by farmland or equipment. The provision applies to discharge of indebtedness income realized after the date of enactment.

B. Timber Provisions

1. Preproductive expenses of growing timber

The conference agreement retains present law treatment with regard to the preproductive expenses of growing timber.

2. Reforestation expenses

The conference agreement retains present law treatment, allowing up to $10,000 of reforestation expenditures incurred in each taxable year to qualify for amortization over a seven-year period, and also a 10-percent tax credit.

3. Capital gains for timber

The capital gains rate for timber is conformed to the top individual and corporate tax rates, effective in accordance with the general amendments to the treatment of individual and corporate capital gains. Taxpayers are permitted to revoke elections (under sec. 631(a)) to treat cutting of timber as a sale or exchange.

C. Oil, Gas, and Geothermal Properties

1. Intangible drilling costs

The conference agreement generally retains the present-law tax treatment of domestic IDCs, but increases to 30 percent the present-law reduction in expensible IDCs of integrated producers. This 30-percent amount must be amortized over a five-year, straight-line period.

IDCs incurred on wells located outside the United States (other than nonproductive wells) are to be recovered (i) using 10-year, straight-line amortization, or (ii) at the taxpayer's election, as part of the basis for cost depletion.

These provisions are generally effective for costs paid or incurred after December 31, 1986.

2. Percentage depletion for bonuses and advance royalties

The conference agreement denies percentage depletion for lease bonuses, advance royalties, or any other amount payable without regard to actual production from an oil, gas, or geothermal property. This reverses the holding in *Commissioner* v. *Engle*, 464 U.S. 206 (1984).

D. *Hard Minerals*

1. Exploration and development costs

The conference agreement generally retains the present-law treatment of domestic mining exploration and development costs. However, the reduction in expensible exploration and development costs for corporations (under sec. 291) is increased to 30 percent. This 30-percent amount is required to be amortized over a five-year, straight-line period.

In the case of foreign mines, exploration and development costs are recovered by (1) 10-year straight-line amortization or (2) at the election of the taxpayer, as part of the basis for cost depletion.

These provisions are effective for costs paid or incurred after December 31, 1986.

2. Percentage depletion of hard mineral deposits

The conference agreement increases the reduction in corporate coal and iron ore percentage depletion deductions (under sec. 291) from 15 to 20 percent, effective for taxable years beginning after December 31, 1986. Present-law depletion rates are retained for hard minerals.

3. Gain on disposition of interest in mineral properties

The conference agreement expands the amount of gain that must be treated as ordinary income on the disposition of oil, gas, or geothermal property to include the amount of depletion deductions that have previously reduced basis, in addition to intangible drilling costs. Similar rules are applied for mining exploration and development costs. The new provisions generally apply to property placed in service by the taxpayer after 1986.

E. Energy-Related Tax Credits and Other Incentives

1. Business energy tax credits

The solar energy tax credit is extended for three years at 15 percent in 1986, 12 percent in 1987, and 10 percent in 1988.

The geothermal energy tax credit is extended for three years at 15 percent in 1986, and 10 percent in 1987 and 1988.

The conference agreement does not extend to dual purpose solar or geothermal energy property. The conference committee, howev-

er, notes with respect to this matter that there are administrative issues which the Treasury Department should resolve under the regulatory authority provided in the Energy Tax Act of 1978 and subsequent Acts with provisions relating to energy tax credits.

The ocean thermal energy tax credit is extended for three years at 15 percent.

The biomass energy tax credit is extended for two years at 15 percent in 1986 and 10 percent in 1987.

Energy tax credits earned under the affirmative commitment rules will be treated in the same manner as the general investment tax credit for transition property.

2. Alcohol fuels

The conference agreement generally incorporates the language of section 864 of H.R. 4800, which permits duty-free entry of (1) ethyl alcohol which has been both fermented and dehydrated in an insular possession or a CBI country, or (2) ethyl alcohol dehydrated in an insular possession or CBI country produced using hydrous ethyl alcohol which is wholly the product of manufacture of any insular possession or beneficiary country having a value not less than 30 percent in 1987, 60 percent in 1988, and 75 percent thereafter of the value of the ethyl alcohol or mixture.

Ethyl alcohol imported for other than fuel uses is excluded from tariff through a certification process with evidence of actual use presented within a reasonable time. The definition of ethyl alcohol is clarified to include mixtures containing ethyl alcohol which are suitable for use as fuel or in producing a fuel.

These provisions apply to articles entered after December 31, 1986, subject to certain transition provisions.

3. Neat alcohol fuels

The nine-cents-per-gallon exemption from the motor fuels excise tax for neat alcohol fuels (methanol and ethanol) is reduced to six-cents per-gallon after December 31, 1986.

4. Taxicab fuels tax exemption

The four-cents-per-gallon excise tax exemption from the motor fuels excise taxes for taxicabs meeting specified requirements is extended from October 1, 1985, through September 30, 1988.

Title V. Tax Shelters; Interest Expense

A. At-Risk Rules

The at-risk rules are extended to the activity of holding real property, with an exception for qualified nonrecourse financing which is secured by real property used in the activity. Under this rule, real estate joint ventures may obtain financing from an otherwise qualified lender who has an equity interest in the venture, provided that the terms of financing are commercially reasonable and substantially similar to loans made to unrelated parties. Seller financing is not treated as qualified nonrecourse financing.

This provision is effective with respect to property acquired after December 31, 1986.

B. Limitations on Losses and Credits from Passive Activities

Deductions from passive activities, to the extent that they exceed income from all such activities (exclusive of portfolio income), generally may not be deducted against other income of the taxpayer. Similarly, credits from passive activities generally are limited to the tax allocable to the passive activities. Suspended losses and credits are carried forward and treated as deductions and credits from passive activities in the next taxable year. When the taxpayer disposes of his entire interest in an activity, any remaining suspended loss incurred in connection with that activity is allowed in full.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate (e.g., a limited partnership interest in an activity), and rental activities. Passive activities do not include working interests in oil and gas property in which the taxpayer's form of ownership does not limit liability. Interest attributable to passive activities is not treated as investment interest (see C., below).

In the case of rental real estate activities in which an individual actively participates, up to $25,000 of losses (and credits, in a deduction-equivalent sense) from all such activities may be taken in each year against non-passive income of the taxpayer. This amount is phased out ratably between $100,000 and $150,000 of adjusted gross income (determined without regard to passive losses).

The rehabilitation and low income housing credits (but not losses from such activities except to the extent stated above) may be used to offset tax on up to $25,000 of non-passive income regardless of whether the taxpayer actively participates, subject to a phaseout between $200,000 and $250,000 of adjusted gross income (disregarding passive losses). The exceptions under the passive loss rule for the low income housing credit apply only (for the original credit compliance period) to property placed in service before 1990, except

if the property is placed in service before 1991 and 10 percent or more of the total project costs are incurred before 1989.

The provision generally applies to individuals, estates, trusts, and personal service corporations (as defined for purposes of the provision). Certain closely held corporations are subject to a more limited rule under which passive losses and credits may not be applied to offset portfolio income.

The provision is effective for taxable years beginning after December 31, 1986, but is phased in over five years for interests in passive activities in which the taxpayer invested prior to the date of enactment. During the phase-in period, the amount of excess losses and credits from such activities that are disallowed is limited to 35 percent in taxable years beginning in 1987, 60 percent in taxable years beginning in 1988, 80 percent in taxable years beginning in 1989, 90 percent in taxable years beginning in 1990, and 100 percent in taxable years beginning in 1991 and thereafter. Any passive loss which is disallowed for a taxable year during the phase-in period and carried forward may be allowed in a subsequent year only to the extent there is net passive income in the subsequent year (or the activity is disposed of).

C. Interest Deduction Limitation

No deduction is allowed for personal interest (such as interest on car loans or credit card balances for personal expenditures). Interest on underpayments of tax (other than certain deferred estate taxes) is treated as personal interest under the provision. Interest on debt secured by the principal residence or a second residence of the taxpayer is deductible only to the extent the amount of the debt does not exceed the purchase price of the residence plus the cost of improvements, except that home mortgage interest on debt in excess of the purchase price plus improvements, up to the fair market value of the residence, is deductible if the debt is incurred for educational or medical purposes.

The deduction for investment interest is generally limited to the amount of net investment income. Interest (and income) from activities subject to the passive loss rules is not treated as investment interest (or investment income). In calculating net investment income, passive losses that are allowed under the passive loss phase-in provision are subtracted from investment income.

The provision is effective for taxable years beginning after December 31, 1986 but is phased in. During the phase-in period, the amount of interest disallowed under the provision is limited to 35 percent in taxable years beginning in 1987, 60 percent in taxable years beginning in 1988, 80 percent in taxable years beginning in 1989, 90 percent in taxable years beginning in 1990, and 100 percent in taxable years beginning in 1991 and thereafter. Interest that is disallowed for a taxable year during the phase-in period and carried forward may be allowed in a subsequent year only to the extent there is investment income in excess of net investment interest paid or incurred in such subsequent year.

Title VI. Corporate Taxation

A. Corporate Tax Rates

The conference agreement provides a three-bracket graduated corporate rate structure as follows:

Taxable income:	*Tax rate*
Not over $50,000	15%
Over $50,000 but not over $75,000	25%
Over $75,000	34%

This structure reduces from five to three the number of corporate income tax brackets, and lowers from 46 to 34 the tax rate applicable to large corporations. The benefit of graduated rates is fully phased out for corporations with more than $335,000 of taxable income (compared to $1,405,000 under present law).

The graduated income tax rates are effective for taxable years beginning on or after July 1, 1987. For taxable years including July 1, 1987, blended rates will apply.

(See Title III.B., above, regarding corporate long-term capital gains.)

B. Corporate Dividends Paid Deduction

The conference agreement does not adopt the House bill provision, which would have provided a new 10-percent dividends paid deduction phased in over 10 years.

C. Corporate Dividends Received Deduction

The 85-percent dividends received deduction under present law is reduced to 80 percent for dividends received after December 31, 1986.

D. Extraordinary Dividends

The conference agreement requires the basis of stock held by a corporation to be reduced by the untaxed portion of extraordinary dividends, if the stock has not been held for at least two years before the date of announcement or agreement about the dividend, with provisions for certain joint venture agreements and preferred stock dividends. For purposes of determining whether a dividend is extraordinary under the two-year rule, a taxpayer may measure the dividend by reference to the market value of the stock rather than its basis, provided market value is established to the satisfaction of the IRS. Certain other distributions are also treated as extraordinary dividends requiring basis adjustments.

The two-year provision applies to dividends announced after July 18, 1986; other modifications apply to dividends declared after date of enactment.

E. Dividend Exclusion for Individuals

The $100 dividend exclusion for individuals ($200 for a joint return) is repealed, effective for taxable years beginning after December 31, 1986.

F. Stock Redemption Payments

The conference agreement provides that no amount paid or incurred by a corporation in connection with a redemption of its stock is deductible or amortizable. This would preclude, for example, deduction of so-called "greenmail" payments made to stockholders to avert a hostile takeover. The provision is effective for amounts paid or incurred after February 28, 1986.

G. Limitations on Net Operating Loss (NOL) Carryovers

The conference agreement modifies the special limitations on the use of net operating loss (NOL) and other carryforwards.

After a change in ownership of more than 50 percent of value of stock in a loss corporation, however effected, the taxable income available for offset by pre-ownership change NOLs is limited to the long-term tax-exempt rate for the ownership change date, times the value of the loss corporation's equity. In addition, NOL carry forwards are disallowed unless the loss corporation satisfies the continuity-of-business-enterprise rule that applies to tax-free reorganizations for the two-year period following an ownership change, regardless of the type of transaction that results in the change of control. The conference agreement also expands the scope of the special limitations to include built-in losses (other than depreciation) and takes into account built-in gains.

In certain circumstances, creditors who exchange debt for stock in a bankruptcy are treated as continuing shareholders with a provision for reducing NOLs by interest deductions taken with respect to exchanged debt within three years prior to the exchange. However, NOLs are reduced by 50 percent of the excess of the discharged debt over the value of the stock transferred to the creditors, and there are restrictions on subsequent ownership changes within two years.

The conference agreement includes a number of rules designed to ensure the limitations accomplish their intended objectives and makes other changes to present law, of a more technical nature, including rules relating to the measurement of beneficial ownership. Similar rules are applied to carryforwards other than NOLs, such as net capital losses and excess foreign tax credits, as well as passive activity losses and credits and minimum tax credits under the conference agreement.

In general, the provisions apply to changes in ownership that occur after December 31, 1986 (unless pursuant to plans of tax-free reorganization adopted before January 1, 1987, or petitions filed in bankruptcy court before August 14, 1986).

H. Gain or Loss on Liquidating Sales and Distributions

The conference agreement provides that, in general, gain or loss is recognized to a corporation on a distribution of its property in complete liquidation, as if it had sold the property at fair market value. This repeals the so-called *General Utilities* rule. An exception is provided for carryover basis distributions to certain controlling corporate shareholders. There is no general exception for distributions to noncorporate, long-term shareholders; however, there is additional transition relief for certain small, closely held companies.

The provision generally applies to liquidations completed after December 31, 1986 (including deemed liquidations under section 338 where the acquisition date is after December 31, 1986). However, liquidations completed before January 1, 1988 (including deemed liquidations under section 338 where the acquisition date is before 1988) are grandfathered if pursuant to a plan of liquidation adopted before August 1, 1986 or a binding contract for sale of the company entered into before August 1, 1986. Liquidations grandfathered under the special definitions of the House bill as to what constituted adequate action before November 20, 1985 are also grandfathered if they are completed before January 1, 1988. Complete relief (except for ordinary income and short-term gain property) is provided for small, closely held companies on liquidations completed before January 1, 1989. Such companies are those not exceeding $5 million in value and more than 50 percent of whose stock is owned directly or indirectly for a substantial period by no more than 10 individuals. Relief phases out for such closely held companies with value between $5 and $10 million.

The Treasury Department is to study reform of subchapter C and report to the tax-writing committees by January 1, 1988.

I. Allocation of Purchase Price in Certain Asset Sales

The conference agreement conforms the basis allocation rules in asset acquisitions to the rules for stock acquisitions where basis is stepped up (under section 338 rules) so that both buyer and seller would use the so-called "residual" method of allocating the purchase price to nondepreciable goodwill and going concern value. The Treasury Department is authorized to require information reporting with respect to purchase price allocations. The provision applies to transactions after May 6, 1986, unless pursuant to a binding contract in effect on that date.

J. Related Party Sales

The conference agreement modifies the rules that limit installment sales treatment and ordinary income treatment on certain sales between related parties. The definition of related parties is expanded so that persons and entities with certain more than 50-percent relationships are covered (rather than the 80-percent relationships under present law) and certain other cases are covered. In some cases, ratable basis recovery and conformity between buyer and seller regarding recognition of income and basis are required, instead of denying deferred income treatment to the seller.

This provision applies to sales after the date of enactment, unless made pursuant to a binding contract in effect before August 14, 1986.

K. Amortizable Bond Premium

The conference agreement requires amortizable bond premium deductions to be treated as interest, except as provided in regulations.

L. Cooperative Housing Corporations

Under the conference agreement, cooperative housing corporations that charge tenant-stockholders with a portion of the cooperative's interest or taxes in a manner that reasonably reflects the cost to the cooperative of the interest or taxes allocable to each tenant-stockholder's dwelling unit, may elect to have such tenant-stockholders deduct the separately allocated amounts for income tax purposes (rather than amounts based on proportionate ownership of shares of the cooperative).

In addition, under the conference agreement, the tax treatment of individuals owning stock in cooperative housing corporations is extended to corporations, trusts, and other entities that are stockholders. Also, the conference agreement disallows maintenance and lease deductions by tenant-stockholders in situations where the amount paid by such tenant-stockholders is properly chargeable to the capital account of the cooperative. These provisions are effective for taxable years beginning after December 31, 1986.

M. Real Estate Investment Trusts

The conference agreement modifies several aspects of the requirements for qualification as, and the taxation of, real estate investment trusts (REITs). Under the conference agreement, relief is granted from certain shareholder and income and asset requirements for the first year that an entity otherwise qualifies as a REIT. In addition, relief is granted from certain income and asset requirements for the first year after a REIT receives new equity capital and certain new debt capital. REITs also are permitted to hold assets in wholly owned subsidiaries under the conference agreement.

The conference agreement modifies the definition of rents from real property to permit REITs to perform those services that would not result in the receipt of unrelated business income if performed by certain tax-exempt entities, without using an independent contractor. The conference agreement also includes in the definition of rents from real property and the definition of interest, rent, or interest that is based on the net income of the tenant or debtor, but only if such net income is based on amounts that would be treated as rents from real property if received directly by the REIT. The conference agreement also permits income from certain shared appreciation mortgages to be treated as qualifying income for a REIT.

The conference agreement provides certain relief from the distribution requirement where a REIT has certain types of income that are not accompanied by the receipt of cash. The REIT is required to pay tax on amounts not distributed, however. The conference agreement also applies to REITs the same minimum requirement

for distribution within a taxable year applicable to regulated investment companies. In addition, the safe harbor under which sales by a REIT may not be treated as prohibited transactions is expanded, the computation of the amount of capital gains dividends that a REIT may pay is modified, and one of the penalties relating to the distribution of deficiency dividends is eliminated.

These provisions generally are effective for taxable years beginning after December 31, 1986.

N. Mortgage-Backed Securities

The conference agreement provides a new vehicle, referred to as a real estate mortgage pool (REMP) for the issuance of multiple class mortgage-backed securities. The REMP may be created in the form of a corporation, partnership or trust. The assets that the REMP is permitted to hold generally are limited to mortgages secured by real property.

Under the conference agreement, the net income of the REMP is allocated to and taken into account by holders of "regular" and "residual" interests in the REMP. Amounts in excess of an imputed yield on the residual interest are treated as unrelated business income, are subject to withholding at the statutory rate, and may not be offset by net operating losses (other than net operating losses of thrift institutions).

The conference agreement provides rules relating to the transfer of mortgages to a REMP in exchange for regular or residual interests. In addition, the conference agreement provides rules relating to subsequent transfers of regular and residual interests. The conference agreement also clarifies the application of the original issue discount and market discount rules for certain mortgage-backed securities. In addition, the conference agreement contains certain provisions which are intended to assure that only one set of Federal income tax consequences arises from the issuance of multiple class mortgage-backed securities.

These provisions generally are effective for taxable years beginning after December 31, 1986. The provisions relating to other type of entities issuing mortgage-backed securities generally are effective as of January 1, 1992.

O. Regulated Investment Companies

Under the conference agreement, regulated investment companies (RICs) are required to distribute in each calendar year all but a de minimis amount of their ordinary income and all but a portion of their capital gains derived during the year. Also, RICs are required to pay a five-percent nondeductible excise on distributions to the extent that the distribution requirement for the calendar year is not met.

In addition, the conference agreement provides that permitted income for RICs generally includes income from foreign currencies, and options and futures contracts, derived with respect to the RIC's business of investing. In the case of RICs that have series funds, each fund is treated as a separate corporation. The time for filing notices for capital gains dividends and certain other purposes is extended from 45 to 60 days. RICs are treated as third party recordkeepers. In applying the "short-short test," certain gains from

hedging transactions are not taken into account. Business development companies are eligible to elect RIC status. Certain institutional RICs are permitted to deduct preference dividends.

These changes generally are effective for taxable years beginning after December 31, 1986.

P. Definition of Personal Holding Company Income

An exception from the definition of personal holding company income and foreign personal holding company income is provided for computer software royalties received by certain corporations that are actively engaged in the business of developing computer software, effective for past and future years. An exception from the definition of personal holding company income also is provided for certain interest income of a specified broker dealer in securities, effective for interest received on or after the date of enactment.

Title VII. Minimum Tax Provisions

A. Individual Minimum Tax

The present-law individual alternative minimum tax is retained with the following modifications.

The minimum tax rate is increased to 21 percent. The exemption amount is phased out at a rate of 25 cents on the dollar for alternative minimum taxable income in excess of $150,000 ($112,500 for single taxpayers and $75,000 for married taxpayers filing separately).

Accelerated depreciation on all property placed in service after 1986 (other than property granted a transitional exception for regular tax depreciation and investment tax credit purposes) is a preference to the extent different from alternative depreciation (using the 150 percent declining balance method for personal property). The preference for intangible drilling cost deductions is reduced by 65 percent of net oil and gas income. Tax-exempt interest on newly issued private activity bonds (but not qualified 501(c)(3) bonds) and untaxed appreciation on charitable contributions of appreciated property are preferences. Use of the completed contract method of accounting and of the installment method are preferences.

Certain passive farm losses are denied, and the rule limiting passive losses for regular tax purposes applies under the minimum tax without a phase-in. The definition of investment interest is conformed to that applying for regular tax purposes, and a carryforward is provided for disallowed interest deductions.

Certain timing preferences (such as depreciation) are measured for post-1986 property on an aggregated basis, instead of item-by-item without netting. A credit is allowed against the regular tax for prior years' minimum tax liability attributable to timing preferences. Net operating losses and foreign tax credits are not permitted to reduce the minimum tax liability that otherwise would arise (disregarding regular tax liability) by more than 90 percent.

These provisions apply to taxable years beginning after December 31, 1986. The treatment of interest on private activity bonds as a preference item applies to bonds issued after August 7, 1986, except that in the case of bonds covered under the Joint Statements on Effective Dates of March 14, 1986, and July 17, 1986, such treatment applies to bonds issued on or after September 1, 1986.

B. Corporate Minimum Tax

An alternative minimum tax, similar to the individual minimum tax, replaces the present-law add-on tax. The rate is 20 percent, and there is a $40,000 exemption amount (phased out at the rate of 25 cents on the dollar for alternative minimum taxable income in excess of $150,000).

The items of tax preference include the corporate preferences under present law, accelerated depreciation (to the extent different from alternative depreciation, using the 150 percent declining balance method for personal property) for all property (other than transitional property) placed in service after 1986, intangible drilling costs (with an offset for 65 percent of net oil and gas income), use of the completed contract method of accounting and of the installment method, capital construction funds for shipping companies, and mining exploration and development costs. Tax-exempt interest on newly issued private activity bonds (but not qualified 501(c)(3) bonds), and untaxed appreciation on charitable contributions of appreciated property are preferences.

For 1987 through 1989, one-half of the excess of pre-tax book income of the taxpayer (including members of a group filing a consolidated tax return for the year), over other alternative minimum taxable income, is a preference. After 1989, pre-tax book income is replaced for this purpose by earnings and profits, with certain adjustments.

Rules similar to those under the individual alternative minimum tax apply to incentive credits, the foreign tax credit, net operating losses, and the credit for minimum tax liability attributable to timing preferences. As a transition rule, investment tax credits generally are permitted to offset 25 percent of minimum tax liability.

These provisions apply to taxable years beginning after December 31, 1986. The treatment of interest on private activity bonds as a preference item applies to bonds issued after August 7, 1986, except that in the case of bonds covered under the Joint Statements on Effective Dates (described above), such treatment applies to bonds issued on or after September 1, 1986.

Title VIII. Accounting Provisions

A. Limitations on the Use of the Cash Method of Accounting

The conference agreement prohibits the use of the cash method of accounting by any C corporation, partnership that has a C corporation as a partner, tax-exempt trust with unrelated business income, or tax shelter. Excepted entities, that may continue to use the cash method, are farming and timber businesses, qualified personal service corporations, and entities (other than tax shelters) with average annual gross receipts of $5 million or less.

Qualified personal service corporations are corporations that meet a function test and an ownership test. The function test is met if substantially all the activities of the corporation are the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. The ownership test is met if substantially all of the value of the outstanding stock of the corporation is owned by present or retired employees, the estates of such persons, by any person who acquired its ownership interest as the result of the death of such a person within the last 24 months, or by a holding company the stock of which is owned by employees of the corporation or employees of an affiliate of the corporation that is engaged in the same field of service. Stock owned by an ESOP or pension plan is considered as owned by the beneficiaries of the plan.

The provision is effective for taxable years beginning after December 31, 1986. Any adjustment required by the provision is to be taken into income over a period not to exceed four years.

B. Simplified Dollar-Value LIFO Method for Certain Small Businesses

The conference agreement provides an election to use a simplified method of computing LIFO inventory values for taxpayers with average annual gross receipts of $5 million or less, effective for taxable years beginning after December 31, 1986. The method uses inventory pools established in accordance with general categories of inventory items published by the Bureau of Labor Statistics.

C. Installment Sales

Under the conference agreement, use of the installment method is denied for sales pursuant to a revolving credit plan and for sales of certain publicly traded property.

The conference agreement also limits the use of the installment method based on the ratio of the taxpayer's debt to assets for all sales of property held for sale to customers, and for sales of real property used in a trade or held for the production of rental income, if the selling price of such property exceeds $150,000. The provision does not apply, however, to installment obligations aris-

ing from the sale of crops, livestock held for slaughter, and certain farm property. Personal use property, and debt related to such property, is not taken into account in applying the limitation.

Taxpayers selling certain residential lots and timeshares are permitted to elect to pay interest on the deferral of tax liability attributable to the use of the installment method, rather than be subject to the limitations under the conference agreement. An exception from the provisions of the conference agreement is provided for certain sales by a manufacturer to a dealer where the term of the installment obligation is based on the time that the property is resold by the dealer.

The denial of use of the installment method for sales pursuant to revolving credit plans and for sales of certain publicly traded property is effective for sales after December 31, 1986. Taxpayers selling property on revolving credit plans are permitted to spread any adjustment arising from the change in accounting method over a period not exceeding four years. The limitation on the use of the installment method based on the ratio of the taxpayer's debt to assets is effective as of January 1, 1987, for sales on or after March 1, 1986.

D. Capitalization of Inventory, Construction, and Development Costs

The conference agreement provides that, in general, uniform rules for determining costs that must be capitalized apply to all persons who produce property or acquire property for resale. Thus, the rules apply to inventory, noninventory property produced or held for sale to customers, and assets constructed for self-use. The rules are based on present law capitalization rules applicable to extended period long-term contracts. Interest is subject to a special rule requiring capitalization only if the property is real property, long-lived property, or property requiring more than two years (one year in the case of items costing more than $1 million) to produce.

An exception from the rules is provided for personal property held for resale by retailers and wholesalers whose average annual gross receipts do not exceed $10 million. Simplified methods of absorbing costs will be provided under regulations for personal property held by resale by other retailers and wholesalers.

The uniform capitalization rules generally apply to costs paid or incurred after December 31, 1986. In the case of inventories, the rules apply to the taxpayer's first taxable year beginning after December 31, 1986.

E. Long-Term Contracts

The conference agreement requires certain changes to methods of accounting for long-term contracts.

F. Reserves for Bad Debts

The conference agreement generally repeals the reserve method of computing deductions for bad debts, other than for certain financial institutions (see IX.A., below). The reserve method of computing deductions for losses on debt obligations guaranteed by a dealer also is repealed. Taxpayers that are not allowed to continue to use the reserve method are allowed a deduction for bad debts when the debt becomes wholly or partially worthless. The balance of any re-

serve for bad debts or guarantees is taken into income ratably over a period of four years.

The provision is effective for taxable years beginning after December 31, 1986. A partner in a partnership or a shareholder in an S corporation, that would otherwise be required by this provision to include more than 12 months of income in a single taxable year, may include such excess in income rotably over a period of four taxable years.

G. Taxable Year of Partnerships, S Corporations, and Personal Service Corporations

The conference agreement requires that partnerships, S corporations, and personal service corporations use a taxable year that generally conforms to the taxable year of their owners.

A partnership must use (in order of priority) the taxable year of the partners owning the majority of partnership profits and capital, the taxable year of all of its principal partners, or the calendar year. An S corporation or a personal service corporation must use the calendar year. An exception is made for any partnership, S corporation, or personal service corporation that establishes to the satisfaction of the Secretary of the Treasury a business purpose for having a different taxable year. The deferral of income to partners or shareholders for any period is not to be treated as a business purpose. Personal service corporations may not deduct payments to owner-employees prior to the year such payments are made.

The provision is effective for taxable years beginning after December 31, 1986. A partner in a partnership or a shareholder in an S corporation, that would otherwise be required by this provision to include more than 12 months of income in a single taxable year, may include such excess in income ratably over a period of four taxable years.

H. Special Treatment of Certain Items

1. Qualified discount coupons

The conference agreement repeals the election to deduct the cost of redeeming qualified discount coupons that are received for redemption after the close of the taxable year. A deduction will be allowed only for the cost of redeeming coupons that have been received by the close of the taxable year. The repeal of the election is effective for taxable years beginning after December 31, 1986.

2. Utilities using accrual accounting

The conference agreement provides that taxpayers using the accrual method of accounting must recognize income attributable to the sale or furnishing of utility services to customers not later than the year in which such services are provided to customers. The provision is effective for taxable years beginning after December 31, 1986. Any adjustment required by the provision is to be taken into income ratably over a period of four taxable years.

3. Contributions in aid of construction

The conference agreement provides that a utility must include in gross income the value of any property, including money, that it

receives to encourage it to provide services to, or for the benefit of, the person transferring the property. The provision of present law that allows certain utilities to treat these amounts as contributions to capital is repealed. The change is effective for contributions received after December 31, 1986.

4. Discharge of indebtedness of solvent taxpayers

The conference agreement repeals the provision of present law that allows income from the discharge of qualified business indebtedness to be excluded from gross income. Income from the discharge of indebtedness must be recognized currently unless the discharge occurs in a title 11 (bankruptcy) case or when the debtor is considered to be insolvent. The provision is effective for discharges of indebtedness occurring after December 31, 1986.

Title IX. Financial Institutions

A. Reserve for Bad Debts

1. Commercial banks

Commercial banks may continue to compute their deductions for losses on bad debts under present law, except that "large banks" must use the specific charge-off method to compute the deduction for bad debts. A bank is considered to be a large bank if, for any taxable year beginning after 1986, the sum of the average adjusted bases of the assets of the bank (or of the assets of any controlled group to which the bank is a member) exceeds $500 million.

Large banks required to change their method of accounting for bad debts must recapture the balance in reserve for bad debts over a period of four years (10 percent in the first year, 20 percent in the second, 30 percent in the third, and 40 percent in the fourth), or are required to account for bad debts on existing loans under a "cutoff" method. A large bank is not required to recapture any of its existing reserves during any year in which the bank is "troubled," i.e., if the amount of its nonperforming loans exceeds 75 percent of its equity capital.

These changes are effective for taxable years beginning after December 31, 1986.

2. Thrift institutions

Thrift institutions that use the reserve method to compute their deductions for losses on bad debts may do so using either the experience method allowed to small banks, or the percentage of taxable income method with the percentage reduced to eight percent from 40 percent. In order to be eligible for the special treatment of bad debt reserves, at least 60 percent of the assets of the institution must be invested in qualifying assets.

The excess of the bad debt deduction of thrift institutions computed under the percentage of taxable income method over the deduction computed under the experience method is treated as a tax preference for alternative minimum tax purposes. The excess will not, however, constitute a preference item for purposes of the 20-percent reduction of present law for corporate tax preferences.

These provisions apply to taxable years beginning after December 31, 1986.

B. Interest on Debt to Purchase or Carry Tax-Exempt Obligations

The conference agreement disallows 100 percent (as opposed to 20 percent under present law) of deductions of all financial institutions for interest expense allocable to tax-exempt obligations acquired after August 7, 1986. A 20-percent disallowance continues to apply with respect to tax-exempt obligations acquired after December 31, 1982, and before August 8, 1986. Certain governmental and

section 501(c)(3) organization bonds issued by small governmental units, in aggregate amounts not exceeding $10 million per year, will remain subject to a 20-percent disallowance.

This provision is effective for taxable years ending after December 31, 1986, with respect to tax-exempt obligations acquired after August 7, 1986. A transitional rule is provided for obligations acquired pursuant to a written commitment to purchase entered into before September 25, 1985.

C. Net Operating Loss Carryovers of Financial Institutions

The provision of present law allowing a carryback period of 10 years and a carryforward period of five years for the net operating losses of depository institutions is repealed, effective for losses incurred in taxable years beginning after December 31, 1986, except for the portion of the losses of commercial banks (not including thrift institutions) that are attributable to bad debts in taxable years before 1994. Other losses incurred in taxable years beginning after 1986 are required to be carried back three years and carried forward 15 years in accordance with the general rules for net operating losses. Losses incurred by thrift institutions in years after 1981 and before 1986 may be carried back 10 years and carried forward eight years.

D. Reorganizations of Financially Troubled Thrift Institutions

The conference agreement repeals the special rules of present law that provide special relief to reorganizations of financially troubled thrift institutions. In general, these rules provide that the continuity of interest requirement is satisfied, and net operating losses may be carried over, if the depositors of a financially troubled thrift become depositors of the surviving corporation. In addition, these rules provide that certain payments from the Federal Savings and Loan Insurance Corporation to financially troubled thrifts are exempt from the thrift's income and do not reduce its basis in assets.

The repeal is effective for reorganizations occurring on or after January 1, 1989.

E. Losses on Deposits in Insolvent Financial Institutions

Under the conference agreement, individuals with deposits in certain insolvent financial institutions may elect to deduct as a casualty loss any loss with respect to their deposits at the time it can be reasonably estimated, effective for losses incurred in taxable years beginning after December 31, 1982.

Title X. Insurance Products and Companies

A. Insurance Policyholders

1. Exclusion for interest on installment payments of life insurance proceeds

The conference agreement repeals the provision of present law under which the income on the proceeds of life insurance that are paid to a surviving spouse as periodic payments is includible in gross income only to the extent that the amount of income paid during any taxable year exceeds $1,000. The provision is effective for amounts received by a beneficiary with respect to deaths occurring after the date of enactment.

2. Treatment of structured settlement agreements

The agreement limits the exclusion from income for qualified assignments under structured settlement agreements to those assignments requiring the payment of damages on account of a claim for personal injury or sickness involving physical injury or sickness (including death), effective for assignments entered into after December 31, 1986.

3. Treatment of interest on loans from life insurance policies

A deduction for interest on policyholder loans is not allowed in the case of loans aggregating more than $50,000 per officer, employee, or owner of an interest in any trade or business carried on by the taxpayer. The legislative history restates the present-law rules relating to the deduction for interest on loans incurred to carry or purchase single premium life insurance contracts, including a Senate floor colloquy relating to universal life insurance.

4. Treatment of policies to cover prearranged funeral expenses

Life insurance policies purchased to cover payment of burial expenses or prearranged funeral expenses may be treated as life insurance contracts if (1) the initial death benefit is $5,000 or less in the aggregate per policyholder, (2) the policies provide for fixed annual death benefit increases not exceeding certain amounts, and (3) the death benefit under the contract never exceeds $25,000.

5. Deduction for nonbusiness casualty losses

Under the agreement, in the case of a loss covered (wholly or partially) by insurance, a taxpayer is permitted to deduct a casualty loss for damages to property not used in a trade or business or in a transaction entered into for profit only to the extent of losses not covered by insurance and only if the taxpayer files a timely insurance claim with respect to damage to that property. The provision applies to losses sustained in taxable years beginning after December 31, 1986.

B. Life Insurance Companies

1. Special life insurance company deduction

Under the conference agreement, the special life insurance company deduction equal to 20 percent of tentative life insurance company taxable income (LICTI) is repealed, generally effective for taxable years beginning after December 31, 1986. A special rule is provided for a certain life insurance company.

2. Tax-exempt organizations engaged in insurance activities

The agreement provides, for taxable years beginning after December 31, 1986, that certain organizations (described in secs. 501(c)(3) or (4)) are entitled to tax exemption only if no substantial part of their activities is providing commercial-type insurance, including the issuance of annuity contracts. In addition, the commercial-type insurance activities of an otherwise tax-exempt organization are treated as an unrelated trade or business that is subject to tax under subchapter L.

Commercial-type insurance does not include insurance provided at substantially below cost to a class of charitable recipients, incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations, or property and casualty insurance (such as fire insurance) provided directly or through a wholly owned corporation by a church or convention or association or churches.

In the case of certain existing tax-exempt organizations providing health insurance, the agreement provides that these organizations are (1) taxable as stock property and casualty insurance companies, (2) allowed a deduction for regular tax purposes (not to exceed taxable income) equal to one quarter of the year's annual claims and administrative expenses less prior year's surplus, (3) given a fresh start with respect to accounting methods, including loss reserves, and (4) exempt from the provision of the conference agreement regarding unearned premiums of property and casualty insurance companies. The basis of assets of existing organizations is stepped up to fair market value immediately prior to the effective date for purposes of determining gain.

To be eligible for this special treatment, other organizations are required to satisfy certain conditions: (1) at least 10 percent of accident and health insurance is provided to individuals and small groups (disregarding Medicare supplemental coverage), defining a small group as the lesser of 15 individuals or the number of individuals required for a small group under State law, (2) full-year open enrollment (including conversions) is provided for individuals and small groups, (3) policies covering individuals provide full coverage of pre-existing conditions of high-risk individuals without a price differential (with a reasonable waiting period), and coverage is provided without regard to age, income, or employment status of persons under age 65, and (4) at least 35 percent of enrollment is community rated.

Further, the conference agreement requires the Department of the Treasury to conduct a study of fraternal beneficiary associations (sec. 501(c)(8)) that received gross annual insurance premiums in excess of $25 million in 1984.

Exemptions from the provision are provided for TIAA/CREF (pension business only), for certain church-sponsored insurance, for YMCA (retirement fund), for administrative services performed by municipal leagues, and for the Missouri Hospital Association.

3. Physicians' and surgeons' mutual protection associations

The conference agreement provides that contributions to a pooled malpractice insurance association are currently deductible to the extent they do not exceed the cost of a commercial insurance premium and are included in the association's income, and that refunds of such contributions are deductible to the fund only to the extent included in income of the recipient. The provision applies to associations operating under State law prior to January 1, 1984, and is effective for contributions and refunds after the date of enactment of the bill.

4. Operations loss deduction of insolvent companies

Under the conference agreement, a life insurance company may apply current losses from operations and loss carryovers against the increase in its taxable income attributable to amounts deemed distributed from the policyholder surplus account, if the company is required to be liquidated pursuant to a court order and certain other criteria are met.

C. Property and Casualty Insurance Companies

1. Inclusion in income of 20 percent of unearned premium reserves

Under the conference agreement, 20 percent of the annual increase in unearned premiums is included in property and casualty insurance company income. Also, 20 percent of the unearned premium reserve outstanding at the end of the most recent taxable year beginning before January 1, 1987, is included ratably over a six year period commencing with the first taxable year beginning after December 31, 1986.

In the case of insurance against default in the payment of principal or interest on securities with a maturity of five years or more (i.e., bond insurance), the percentage of unearned premiums included in income is 10 percent, rather than 20 percent.

If a property and casualty insurance company ceases to be subject to tax as a property and casualty insurance company, the remaining portion (if any) of the amount to be ratably included over six years is includible for the taxable year preceding the taxable year in which the company ceases to be taxed as a property and casualty insurance company.

2. Treatment of certain dividends and tax-exempt income

For taxable years beginning after December 31, 1986, a property and casualty insurance company's deduction for losses incurred is reduced by a portion of the company's tax-exempt income and the deductible portion of dividends received (with special rules for dividends from affiliates). The portion taken into account is 15 percent of tax-exempt income and the deductible portion of dividends received from investments made after August 7, 1986.

3. Treatment of loss reserves

The deduction for unpaid losses (i.e., reported losses that have not been paid, estimates of losses incurred but not reported, resisted claims, and unpaid loss adjustment expenses) is limited to the amount of discounted unpaid losses. This provision applies to property and casualty lines of business reported on Schedules O and P of the annual statement approved by the National Association of Insurance Commissioners, to accident and health reserves (other than life insurance reserves subject to discounting under life insurance company tax rules), and to international and reinsurance lines of business. This treatment applies to loss reserves of both property and casualty insurance companies and life insurance companies to the extent such loss reserves are not subject to life insurance company reserve rules. Loss adjustment expenses of life insurance companies are not subject to discounting because they are not deductible.

In the case of title insurance companies, the agreement applies the discounting rules to the title insurance State law unearned premium reserves. The discounting period is the period over which the unearned premium reserves are deferred under State law, and the discount rate is the rate generally applicable to property and casualty insurers. Title insurance case reserves are subject to discounting under the same method as property and casualty insurance loss reserves.

The amount of the discounted unpaid losses as of the end of any taxable year attributable to any accident year is determined by using (1) the gross amount to be subjected to discounting (i.e., the undiscounted loss reserves), (2) the pattern of payment of claims, including the duration in years over which the claims will be paid, and (3) the rate of interest to be assumed in calculating the discounted reserve.

The interest rate to be applied is 100 percent of the applicable Federal midterm rate applied on a five-year rolling average basis. The loss payment patterns are to be promulgated by the Secretary of the Treasury for 1987 and every fifth year thereafter, taking account of aggregate industry experience for each line of business.

A company may elect to use its own loss payment pattern experience. Special rules are provided for long-tail lines and for international and reinsurance lines of business. The provision is effective for taxable years beginning after 1986, with a fresh start provision and special treatment for reserve strengthening in taxable years beginning after December 31, 1985.

4. Repeal of protection against loss account

Effective for taxable years beginning after December 31, 1986, the deduction for contributions to the protection against loss (PAL) account for mutual property and casualty companies is repealed. Balances in the account are includible in income as under present law.

5. Revision of special treatment for small companies

Under the bill, property and casualty companies (whether stock or mutual) with net written premiums or direct written premiums

(whichever is greater) that do not exceed $350,000 for the taxable year are exempt from tax. Property and casualty companies (whether stock or mutual) with net written premiums or direct written premiums (whichever is greater) that exceed $350,000, but do not exceed $1,200,000, may elect to be taxed only on taxable investment income. In the case of a controlled group, these amounts are determined on a group basis, applying 50-percent control test. The provisions are effective for taxable years beginning after December 31, 1986.

6. Study of property and casualty insurance companies

Under the agreement, the Treasury Department is required to conduct a study of the tax treatment of policyholder dividends of mutual property and casualty insurance companies for regular as well as minimum tax purposes and an examination of whether the property and casualty insurance industry meets revenue targets projected by the agreement.

Title XI. Pensions and Deferred Compensation; Employee Benefits; ESOPs

A. Treatment of Tax-Favored Savings

1. Individual retirement arrangements (IRAs)

Under the conference agreement, deductible IRA contributions are permitted as under present law (1) if an individual (or a married couple) has adjusted gross income (AGI) under a phase out level, or (2) if the individual is not an active participant (or, in the case of a married individual, neither the individual nor his or her spouse is an active participant) in an employer-maintained retirement plan for any part of the plan year ending with or within the individual's taxable year. The phase out begins at $25,000 for an individual and $40,000 for a married couple filing a joint return. For purposes of the phaseout, AGI is determined without regard to any IRA contributions.

For an individual who is an active participant in an employer-maintained retirement plan, the IRA deduction limit is reduced proportionately for AGI between $25,000 and $35,000. For married couples filing a joint return, the IRA deduction limit for each spouse is reduced proportionately for AGI between $40,000 and $50,000, if either spouse is an active participant in an employer-maintained retirement plan.

For purposes of determining whether an individual is an active participant in an employer-maintained retirement plan, an employer-maintained retirement plan means (1) a qualified pension, profit-sharing, or stock bonus plan (sec. 401(a)), (2) a qualified annuity plan (sec. 403(a)), (3) a simplified employee pension (sec. 408(k)), (4) a plan established for its employees by the United States, by a State or political subdivision, or by any agency or instrumentality of the United States or a State or political subdivision, (5) a plan described in section 501(c)(18), or (6) a tax-sheltered annuity (sec. 403(b)).

The conference agreement provides that individuals may make nondeductible IRA contributions to the extent that they are not eligible to make deductible IRA contributions. Earnings on nondeductible IRA contributions are not subject to tax until they are withdrawn.

Under the conference agreement, the rules relating to spousal IRA contributions are amended to eliminate the requirement that the spouse have no earned income for the year in order to be eligible for the spousal IRA contribution.

The conference agreement also amends present law to permit the acquisition by IRAs of certain gold and silver coins issued by the United States.

The provisions are effective for taxable years beginning after December 31, 1986, except that the provision eliminating the require-

ment that the spouse have no earned income in order to be eligible for the spousal IRA contribution is effective for years beginning after December 31, 1985.

2. Qualified cash or deferred arrangements (sec. 401(k) plans)

Under the conference agreement, effective for taxable years beginning after December 31, 1986, the maximum amount that an employee can elect to defer for any taxable year under all cash or deferred arrangements in which the employee participates is limited to $7,000. The $7,000 cap is adjusted for inflation by reference to percentage increases in the dollar limit under a defined benefit plan (sec. 415(d)).

Effective generally for taxable years beginning after December 31, 1986, and, in the case of plans maintained by State or local government employers, for years beginning after December 31, 1988, the conference agreement modifies the special nondiscrimination test applicable to qualified cash or deferred arrangements by (1) modifying the percentage tests, (2) clarifying the rules for aggregating elective contributions with certain nonelective contributions for purposes of the special nondiscrimination test, (3) redefining the group of highly compensated employees and compensation to conform to the new uniform definitions used generally for purposes of the nondiscrimination rules applicable to qualified plans and employee benefit programs (described below), (4) establishing a mechanism for the return of contributions that violate the special nondiscrimination test, and (5) imposing an excise tax on contributions that are not returned (or forfeited) within a specified period of time.

Under the conference agreement, the actual deferral percentage for an employer's highly compensated employees may not exceed 125 percent of the actual deferral percentage of eligible nonhighly compensated employees. Alternatively, the actual deferral percentage of an employer's highly compensated employees may not exceed the lesser of 200 percent of the actual deferral percentage of the nonhighly compensated employees, or the actual deferral percentage of the nonhighly compensated employees plus two percentage points.

The conference agreement modifies certain present-law restrictions and imposes several additional restrictions on qualified cash or deferred arrangements. First, qualifying total distributions may be made to a participant in a qualified cash or deferred arrangement on account of the sale of a subsidiary or of substantially all the assets used in a trade or business or the termination of the plan of which the arrangement is a part, effective for sales or terminations occurring after December 31, 1984.

Second, the conference agreement limits hardship withdrawals under a qualified cash or deferred arrangement to the amount of an employee's elective deferrals. In addition, the conference agreement provides that a qualified cash or deferred arrangement cannot require, as a condition of participation in the arrangement, that an employee complete a period of service with the employer (or employers) maintaining the plan in excess of one year of service, effective for years beginning after December 31, 1988.

Under the conference agreement, effective for years beginning after December 31, 1988, an employer generally may not condition, either directly or indirectly, contributions and benefits (other than matching contributions) upon an employee's elective deferrals. An exception is provided for certain qualified offset arrangements.

The conference agreement provides that qualified cash or deferred arrangements are not available to employees of State or local governments, unless the plan was adopted before May 6, 1986, or to employees of tax-exempt organizations, unless the plan was adopted before July 1, 1986.

3. Employer matching contributions and employee contributions

Under the conference agreement, a special nondiscrimination test is applied to employer matching contributions and employee contributions under all qualified defined contribution plans and employee contributions under a defined benefit plan (to the extent allocated to a separate account on behalf of the employee). This nondiscrimination test applies in lieu of the usual nondiscrimination rules applicable to the amount of contributions under qualified plans and is similar to the special nondiscrimination test applicable to qualified cash or deferred arrangements under the conference agreement.

The provisions generally are effective for plan years beginning after December 31, 1986.

4. Unfunded deferred compensation plans of State and local governments

The conference agreement (1) applies the rules relating to unfunded deferred compensation plans to tax-exempt organizations; (2) requires that amounts deferred on a before-tax basis by an employee under a simplified employee plan (SEP), a qualified cash or deferred arrangement (sec. 401(k)), or other elective contribution arrangement, be taken into account in determining whether the employee's deferrals under an eligible deferred compensation plan exceed the limits on deferrals under the eligible plan; (3) modifies the distribution requirements applicable to eligible deferred compensation plans; (4) permits certain rollovers between eligible deferred compensation plans; and (5) modifies the rule that deferrals under an eligible plan are includible in an employee's income when made available to the employee. An exception is provided for qualified State judicial plans.

The provision relating to application of the unfunded deferred compensation plan rules to tax-exempt organizations is effective for years beginning after December 31, 1986. The distribution provisions are effective for taxable years beginning after December 31, 1988.

5. Deferred annuity contracts

Under the conference agreement, if a deferred annuity contract is held by a person who is not a natural person (e.g., a corporation or a trust is not a natural person), then the contract is not treated as an annuity contract for Federal income tax purposes and the investment income on the contract for any taxable year is treated as

ordinary income received or accrued by the owner of the contract during the taxable year. An exemption from the rule is provided for qualified funding assets purchased by structured settlement companies and annuities held by an employer with respect to a terminated pension plan.

In addition, the conference agreement increases the early withdrawal tax to 10 percent and modifies the circumstances under which the additional income tax on early withdrawals from deferred annuity contracts will be imposed to conform generally to the circumstances under which the early withdrawal tax is imposed under qualified plans pursuant to the conference agreement.

The provisions are effective for years beginning after December 31, 1986.

6. Elective contributions to tax-sheltered annuities (sec. 403(b))

Under the conference agreement, effective for taxable years beginning after December 31, 1986, the maximum amount that an employee can elect to defer for any taxable year under all tax-sheltered annuities in which the employee participates is limited to $9,500. The $9,500 cap will be adjusted for inflation when the $7,000 cap on elective deferrals under a qualified cash or deferred arrangement reaches $9,500. A special catch-up election is provided.

7. Simplified employee pensions (SEPs)

The conference agreement revises the requirements relating to SEPs to permit an employee to elect to have SEP contributions made on the employee's behalf or to receive the contributions in cash without being treated as having constructively received the amounts contributed to the SEP pursuant to the employee's election.

Elective deferrals under a SEP are to be treated like elective deferrals under a qualified cash or deferred arrangement and, thus, are subject to the $7,000 (indexed) cap on elective deferrals. Consistent with the rules applicable to elective deferrals under a qualified cash or deferred arrangement or tax-sheltered annuity under present law, elective deferrals under a SEP are treated as wages for employment tax purposes.

The bill provides that the election to have amounts contributed to a SEP or received in cash is available only if all of the employees of the employer are eligible to make such an election at least 50 percent of the employees of the employer elect to have amounts contributed to the SEP and is available only in a taxable year in which the employer maintaining the SEP has 25 or fewer employees as of the beginning of the year.

In addition, elective deferrals under SEPs are subject to special nondiscrimination rules similar to the special nondiscrimination rules applicable to qualified cash or deferred arrangements.

The conference agreement makes miscellaneous changes to the SEP requirements to decrease the administrative burden of maintaining a SEP.

The provisions are effective for years beginning after December 31, 1986.

8. Salary reduction permitted under section 501(c)(18) plans

Under the conference agreement, employees who participate in a section 501(c)(18) pension plan are permitted to elect to make deductible contributions up to the lesser of $7,000 (coordinated with other elective deferrals) or 25 percent of the compensation of the employee includible in income for the taxable year subject to nondiscrimination rules similar to the rules applicable to qualified cash or deferred arrangements.

The provision is effective for years beginning after December 31, 1986.

B. *Minimum Standards for Qualified Plans*

1. Coverage requirements for qualified plans

Under present law, a qualified plan is required to cover employees in general rather than merely the employees of an employer who are officers, shareholders, or highly compensated. A plan generally satisfies the present-law coverage rule if (1) it benefits a certain percentage of the employer's work force (percentage test), or (2) it benefits a classification of employees determined by the Secretary of the Treasury not to discriminate in favor of employees who are officers, shareholders, or highly compensated (classification test).

The conference agreement modifies the present-law coverage rules to require that at least one of the following tests is satisfied: (a) at least 70 percent of all nonhighly compensated employees are covered by the plan; (b) the percentage of nonhighly compensated employees covered by the plan is at least 70 percent of the percentage of highly compensated employees covered by the plan; or (c) the group of employees covered by the plan satisfies the present-law classification, test and the average benefit provided to nonhighly compensated employees (as a percentage of compensation) is at least 70 percent of the average benefit provided to highly compensated employees (as a percentage of compensation). For purposes of determining whether the average benefit provided to nonhighly compensated employees is at least 70 percent of the average benefit provided to highly compensated employees, all employer-provided benefits and employer contributions, including elective deferrals under a qualified cash or deferred arrangement, are taken into account.

In addition, the conference agreement (1) clarifies the circumstances under which an employee will be treated as benefiting under a plan for purposes of the coverage rules; (2) modifies, for purposes of satisfying the new coverage requirements, the circumstances under which certain categories of employees may be excluded from consideration; (3) establishes a uniform objective definition of those employees in whose favor discriminatory coverage is prohibited; (4) permits satisfaction of certain of the coverage rules on a controlled group or line of business basis; (5) establishes a definition of a separate line of business or operating unit with a special safe-harbor rule; and (6) contains a special transition rule for certain dispositions or acquisitions of a business.

The provisions are generally effective for plan years beginning after December 31, 1988. A special effective date applies to plans maintained pursuant to a collective bargaining agreement.

2. Minimum participation requirement

Under the conference agreement, a plan is not a qualified plan unless it benefits at least (a) 50 employees or (b) 40 percent or more of all employees of the employer (if less). The requirement may not be satisfied by aggregating comparable plans. The requirement does not apply to multiemployer plans. The multiemployer plan exception does not apply to plans maintained pursuant to collective bargaining agreements covering professionals (e.g., doctors or lawyers).

The provisions are generally effective for plan years beginning after December 31, 1988. A special effective date applies to plans maintained pursuant to a collective bargaining agreement. In addition, the conference agreement contains a special transition rule under which plans that do not comply with the minimum participation rule must be merged or terminated by the end of the first plan year to which the rule applies. If a plan is terminated or merged under the special transition rule (1) the present value of accrued benefits must be calculated using an interest rate no lower than a specified rate, and (2) the excise tax on asset reversions does not apply to such a termination or merger.

3. Nondiscrimination rules applicable to tax-sheltered annuities

The conference agreement extends certain nondiscrimination rules to tax-sheltered annuity programs other than those maintained by churches. With respect to employer (i.e., nonelective and matching) contributions to tax-sheltered annuity programs, the bill applies the general coverage and nondiscrimination requirements applicable to qualified pension plans. The conference agreement also directs the Secretary of the Treasury to develop simplified comparability rules for purposes of applying the coverage and nondiscrimination requirements.

With respect to elective contributions to tax-sheltered annuity programs (other than those maintained by churches), the conference agreement provides that an employer that offers any employee the opportunity to make elective deferrals is required to make the opportunity available to all employees, with no more than a de minimis contribution requirement.

The conference agreement also clarifies the definition of an employer for purposes of the nondiscrimination rules applicable to both employer contributions and elective deferrals under a tax-sheltered annuity program. In addition, the conference agreement provides that for purposes of applying the nondiscrimination rules, students who customarily work less than 20 hours per week may be disregarded.

The provisions are generally effective for plan years beginning after December 31, 1988.

4. Integration with Social Security

The conference agreement provides that a plan is not to be considered discriminatory merely because the contributions and benefits under the plan favor highly compensated employees if the plan meets the new requirements (i.e., the disparity limits) of the conference agreement relating to the integration of contributions or benefits under qualified plans.

Under the conference agreement, a defined contribution plan meets the disparity limits for integrated plans only if the contribution percentage under the plan for compensation over the integration level does not exceed the lesser of (1) 200 percent of the contribution percentage for compensation up to the integration level or (2) the sum of the contribution percentage for compensation up to the integration level and a specified rate.

In the case of an integrated excess defined benefit pension plan, the conference agreement limits the benefit percentage for compensation above the integration level to no more than 200 percent of the benefit percentage for compensation up to the integration level. In addition, the conference agreement further provides that the disparity between the benefit percentages for compensation above and below the integration level may not exceed an amount comparable to the disparity permitted under present law and contains rules regarding the accrual of the disparity. The conference agreement also requires that any optional form of benefit, preretirement benefit, actuarial factor, or other benefit or feature provided by the plan with respect to remuneration in excess of the integration level specified by the plan for the year be provided with respect to remuneration that is not in excess of that level.

A defined benefit pension plan meets the requirements for integrated offset plans if it provides that a participant's accrued benefit derived from employer contributions (sec. 411(c)(1)) may not be reduced by reason of the offset by more than 50 percent of the benefit that would have accrued without regard to the reduction. The conference agreement further limits the size of the offset to an amount comparable to that permitted under present law and contains rules as to the rate at which the offset may accrue under a plan.

The provisions are effective for plan years beginning after December 31, 1988. A special effective date applies to plans maintained pursuant to a collective bargaining agreement.

5. Uniform definition of highly compensated employees

The conference agreement provides a new uniform definition of the group of employees in whose favor discrimination is prohibited ("highly compensated employees") that generally applies for purposes of the nondiscrimination rules for qualified plans and statutory employee benefit plans.

An employee is treated as highly compensated with respect to a year if, at any time during the year or the preceding year, the employee (1) was a five-percent owner of the employer; (2) earned more than $75,000 in annual compensation from the employer; (3) earned more than $50,000 in annual compensation from the employer and was a member of the top-paid group of employees, i.e.,

the top 20 percent of employees by pay during the same year; or (4) was an officer of the employer and received compensation greater than 150 percent of the dollar limit on annual additions to a defined contribution plan. Treatment of an employee as a highly compensated employee under the last three categories is subject to the top-100-employee rules, as in both bills. If for any year no officer of the employer received compensation in excess of this level, the highest paid officer of the employer is treated as a highly compensated employee. The $50,000 and $75,000 thresholds are indexed in the same manner as the indexation of the dollar limitation under section 415.

6. Determining top-heavy status

Under the conference agreement, a uniform accrual rule is used in testing whether a qualified plan is top-heavy (or super top-heavy), effective for plan years beginning after December 31, 1986. In determining whether a plan is top heavy, the fractional accrual rule is applied. However, at the employer's election, the top heavy determination may be based on any other accrual method if that method is used for benefit accrual purposes by all plans of the employer.

7. Includible compensation

The conference agreement provides a limit of $200,000 on the amount of compensation that may be taken into account under any plan for purposes of both the nondiscrimination rules and the deduction limits under section 404. The limit on includible compensation is increased in the same manner as the dollar limit on annual additions under a defined benefit plan. The provision is effective for plan years beginning after December 31, 1986.

8. Benefit forfeitures

The conference agreement creates uniform rules for forfeitures under any defined contribution plan, effective for plan years beginning after December 31, 1985.

9. Vesting standards

The conference agreement provides (under the Code and ERISA) that a plan (other than a top-heavy plan subject to separate vesting requirements) is not a qualified plan of an employer unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules.

A plan satisfies the first schedule if a participant has a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the participant's completion of five years of service. A plan satisfies the second alternative schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after three years of service, 40 percent at the end of four years of service, 60 percent at the end of five years of service, 80 percent at the end of six years of service, and 100 percent at the end of seven years of service.

A special rule is provided in the case of a multiemployer plan to require 100-percent vesting after 10 years of service.

The conference agreement also provides that a plan may not condition eligibility to participate in the plan on more than two years of service, and that a plan with a two-years-of-service eligibility requirement must provide for full and immediate vesting after two years of service.

The provisions are generally applicable for plan years beginning after December 31, 1988, with respect to participants who perform at least one hour of service in a plan year to which the new provisions apply. A special effective date applies to plans maintained pursuant to a collective bargaining agreement.

C. Treatment of Distributions

1. Uniform minimum distribution rules

The conference agreement establishes a uniform commencement date for benefits under all qualified plans, IRAs, tax-sheltered annuities, custodial accounts, and unfunded deferred compensation plans of State and local government and tax-exempt employers. Under the agreement, distributions under a qualified retirement plan must commence no later than April 1 of the calendar year following the calendar year in which the participant or owner attains age 70-1/2, without regard to the actual date of retirement.

In addition, the agreement establishes a new sanction, in lieu of plan disqualification, in the form of an excise tax for failure to satisfy the minimum distribution rules.

The provisions generally apply to distributions made after December 31, 1988.

2. Treatment of distributions

The conference agreement (1) phases out capital gains treatment over six years beginning on January 1, 1987, and (2) eliminates 10-year forward averaging for taxable years beginning after December 31, 1986, and, instead, permits a one-time election of five-year forward averaging for a lump-sum distribution received after attainment of age 59-1/2. Under a transition rule, a participant who attained age 50 by January 1, 1986, is permitted to make one election of five-year forward averaging or 10-year forward averaging (at present-law rates) with respect to a single lump sum distribution without regard to attainment of age 59-1/2, and to retain the capital gain character of the pre-1974 portion of such a distribution. Under the transition rule, the capital gains portion would be taxed at a rate of 20 percent.

The conference agreement also (1) modifies the present-law basis recovery rules for amounts distributed prior to a participant's annuity starting date to provide for pro-rata recovery of employee contributions, (2) eliminates the special three-year basis recovery rule of present law, (3) modifies the general basis recovery rules for amounts paid as an annuity to provide that each distribution is treated part as recovery of employee contributions and part as payment of taxable employer contributions (until all employee contributions are recovered), and (4) restricts rollovers of partial distributions to distributions due to separation from service.

The new pre-annuity starting date basis recovery rules and the new restrictions on rollovers of partial distributions are generally

effective with respect to distributions made after December 31, 1986, with a provision preventing avoidance of repeal of the three-year basis recovery rule. Under a transition rule, in the case of a plan that, on May 5, 1986, permitted the withdrawal of employee contributions before separation from service, distributions are treated as made first out of employee nontaxable contributions made before December 31, 1986. The post-annuity starting date basis recovery rules are generally effective with respect to individuals whose annuity starting date is after July 1, 1986.

The conference agreement also provides basis recovery rules (effective January 1, 1987) for distributions from an IRA to which nondeductible contributions have been made, and permits rollovers from frozen deposits in bankrupt or insolvent savings and loan associations after the 60-day rollover election period.

3. Taxation of early distributions from qualified retirement plans

The conference agreement applies a 10 percent additional income tax to withdrawals from a qualified plan, qualified annuity, tax-sheltered annuity, or IRA, made before death, disability, or attainment of age 59 1/2. The additional tax does not apply to certain distributions (1) in the form of an annuity payable over the life or life expectancy of the participant (or the lives or joint life and last survivor expectancy of the participant and the participant's beneficiary), (2) made after the participant has attained age 55, separated from service, and satisfied the conditions for early retirement under the plan, (3) used for payment of medical expenses to the extent deductible under sec. 213, (4) received from an employee stock ownership plan before January 1, 1990, (5) received prior to March 15, 1987, if made on account of separation from service in 1986 if the recipient elects to be taxed on the distribution in 1986, or (6) to an alternate payee pursuant to a qualified domestic relations order.

The provisions generally are effective for distributions in taxable years beginning after December 31, 1986.

4. Tax-sheltered annuities

The conference agreement extends the withdrawal restrictions currently applicable to tax-sheltered custodial accounts to elective contributions made to a tax-sheltered annuity. Withdrawals on account of hardship from a custodial account are permitted only to the extent of contributions made pursuant to a salary reduction agreement (but not earnings on those contributions). The provision is effective for years beginning after December 31, 1986.

5. Loans under qualified plans

The conference agreement modifies the rules relating to the tax treatment of loans under qualified plans by (1) limiting the ability of plan participants to maintain permanent loan balances, (2) limiting the availability of the extended repayment period for loans for principal residences to loans applied to the purchase of the participant's principal residence, and (3) requiring level amortization of a loan over the permissible repayment period.

In addition, the agreement provides a deferral of the deduction (to the extent otherwise allowable under the provisions of the conference agreement) for interest paid by employees on loans secured by elective deferrals from a 401(k) plan or tax-sheltered annuity (sec. 403(b) plan), and also by key employees on loans from any qualified plan. The deferral would be accomplished by denying a deduction for interest, and increasing the participant's basis under the plan by the amount of nondeductible interest paid.

The provisions are generally effective for amounts received as a loan after December 31, 1986.

D. Tax Deferral Under Qualified Plans

1. Overall limitations on contributions and benefits under qualified plans

The conference agreement makes several changes to the overall limits on contributions and benefits under qualified plans, tax-sheltered annuity programs, and SEPs of private and public employers.

The normal retirement age, for purposes of the limit on benefits under a defined benefit pension plan, is conformed to the social security retirement age. If the retirement benefit under a defined benefit plan begins before the social security retirement age (presently, age 65), then the $90,000 limitation on annual benefits generally is reduced so that it is the actuarial equivalent of an annual benefit of $90,000 beginning at the social security retirement age. Under transition rules provided by the conference agreement, benefits already accrued by a plan participant under an existing plan are not affected by the reductions for actuarial equivalence. The changes do not affect plans maintained by tax-exempt employers.

Under the conference agreement, the dollar limit on annual benefits under a qualified defined benefit pension plan is phased-in over 10 years of participation. The agreement provides for rules under which nonabusive benefit increases are not limited by the phase-in.

The conference agreement provides for qualified cost-of-living arrangements. The agreement clarifies the terms under which an employee may obtain an employer provided cost-of-living subsidy.

The conference agreement provides special rules for commercial airline pilots, and participants in a qualified police or firefighters' defined benefit pension plan. The agreement clarifies the definition of a qualified police or firefighters' plan and provides for indexing of the limit applicable under the special rules for those plans. In addition, the agreement clarifies the application of the special rules for pilots who retire before age 60.

With respect to defined contribution plans, the conference agreement adopts the rules of the House bill with respect to cost-of-living adjustments and clarifies the application of the limits for defined contribution plans. Although cost-of-living adjustments will be made to the defined benefit pension plan limit beginning in 1988, no cost-of-living adjustments to the defined contribution plan limit will be made until the $30,000 defined contribution plan limit is equal to 25 percent of the defined benefit dollar limit. The cost-of-living adjustment will be determined by reference to the consumer price index.

Under the agreement, contributions made by retired non-key employees for retiree medical coverage are not subject to the percentage-of-compensation limit on annual additions.

Under the conference agreement, the class of employers whose employees are entitled to the special catch-up elections for tax-sheltered annuities is expanded to include employers that are health and welfare service agencies. The agreement also provides a technical modification clarifying that the catch-up rules apply before separation from service.

The conference agreement provides for a 15-percent excise tax on benefit payments in excess of $112,500. Under the agreement, the tax does not apply to excess benefits accrued before August 1, 1986.

The provisions generally are effective for years beginning after December 31, 1986. Special rules are provided in the case of plans maintained pursuant to collective bargaining agreements.

2. Deductions for contributions to qualified plans

The conference agreement makes several changes to the limits on employer deductions for contributions to qualified plans. The agreement (1) repeals the limit carryforward applicable to profit-sharing and stock bonus plans, (2) extends the 25-percent of compensation combined plan deduction limit to any combination of a defined benefit pension plan and a money purchase pension plan, profit-sharing, or stock bonus plan, and (3) applies a 10-percent excise tax to nondeductible employer contributions. The agreement includes a technical modification relating to fully insured plans.

The provisions are effective for taxable years beginning after December 31, 1986.

3. Excise tax on reversion of qualified plan assets to employer

The conference agreement imposes a 10-percent nondeductible excise tax on a reversion from a qualified plan. The tax is imposed on the person who received the reversion. The agreement provides that the tax does not apply to the portion of a reversion that is transferred to an ESOP under certain circumstances.

The provision applies to reversions received after December 31, 1985, with an exception for a certain employer. The special provision for transfers to an ESOP expires for reversions received after December 31, 1988.

E. Miscellaneous Pension and Deferred Compensation Provisions

1. Discretionary contribution plans

Under the conference agreement, an employer's contribution to a profit-sharing plan is not limited to the employer's current or accumulated profits. This provision applies without regard to whether the employer is tax-exempt. The provision applies for plan years beginning after December 31, 1985.

2. Requirement that collective bargaining agreements be bona fide

The conference agreement clarifies that no agreement will be treated as a collective bargaining agreement unless it is a bona fide

agreement between bona fide employee representatives and one or more employers. The provision is effective upon enactment.

3. Penalty for overstatement of pension liabilities

The conference agreement provides a new penalty in the form of a graduated addition to tax applicable to certain income tax overstatements of deductions for pension liabilities. As an addition to tax, this penalty will be assessed, collected, and paid in the same manner as a tax. This addition to tax applies only to the extent of any income tax underpayment that is attributable to such an overstatement. The penalty is similar to the present-law penalty for overvaluations of liabilities.

The provision is generally effective after December 31, 1986.

4. Treatment of certain fishing boat crews as self-employed individuals

Under the conference agreement, members of fishing boat crews (described in sec. 3121(b)(20) are treated as self-employed individuals for purposes of the rules relating to qualified pension, profit-sharing, or stock bonus plans.

The provision is effective for taxable years beginning after December 31, 1986.

5. Cash out of certain accrued benefits

The conference agreement amends the rules of the Code and ERISA relating to cash outs of accrued benefits to require that, for purposes of determining the present value of a participant's accrued benefit, a plan is to compute the first $25,000 of the present value of a benefit by using an interest rate no greater than the interest rate (deferred or immediate, whichever is appropriate) that would be used by the PBGC (as of the date of distribution) upon the plan's termination. The remaining portion of the present value of the benefit is to be determined by using an interest rate no greater than 120 percent of the PBGC interest rate. In addition, the conference agreement clarifies that certain plan amendments adopting the provision will not constitute a cutback of a participant's accrued benefit.

The provision is applicable for distributions after December 31, 1984. However, it does not apply to distributions that were made after December 31, 1984, and before the date of enactment, if such distributions were made in accordance with the requirements of regulations issued under the Retirement Equity Act of 1984.

6. Time required for plan amendments, issuance of regulations, and development of section 401(k) master and prototype plans

Under the conference agreement a delayed effective date is provided for plan amendments to comply with the provisions of the conference agreement relating to qualified plans.

Further, the conference agreement provides that the Treasury Department is to issue final regulations by February 1, 1988, for (1) the rules relating to the integration of benefits under qualified plans, (2) the coverage requirements applicable to qualified plans, (3) the amendments applicable to qualified cash or deferred ar-

rangements (sec. 401(k) plans), and (4) the new nondiscrimination rules for employer matching and employee contributions (sec. 401(m)).

The conference agreement provides that the Treasury Department is to begin issuing determination letters with respect to master and prototype plans that include qualified cash or deferred arrangements by May 1, 1987.

7. Exemption from the survivor benefit requirements of the Retirement Equity Act of 1984

The conference agreement exempts a plan from the survivor benefits requirements of the Retirement Equity Act of 1984, if (1) the plan was established prior to January 1, 1954, as a result of an agreement between employee representatives and the Federal Government during a period of Government operation, under seizure powers, of a major part of the productive facilities of the industry, and (2) under the plan, participation is substantially limited to participants who, before January 1, 1976, ceased employment covered by the plan.

8. Employee leasing

The conference agreement modifies the safe harbor under which an individual (a leased employee) who performs certain services for another person (the recipient) on a substantially full time basis will not be treated as an employee of the recipient for purposes of the nondiscrimination rules. The conference agreement (1) raises the safe harbor contribution rate under section 414(n)(5) for a plan maintained by a leasing organization from 7-1/2 percent to 10 percent; (2) requires as a condition of the safe harbor that the leasing organization cover 100 percent of its employees (excluding employees who have compensation of less than $1000 for the year); and (3) provides that the safe harbor may not be used if more than 20 percent of the individuals performing substantial services for the recipient organization are leased employees. The conference agreement also provides an exemption from the employee leasing recordkeeping requirements for recipient organizations that have no top-heavy plans and with respect to which only a de minimis percentage of individuals performing substantial services are not employees.

F. Employee Benefit Provisions

1. Nondiscrimination rules for certain statutory employee benefit plans and cafeteria plans

The conference agreement establishes comprehensive nondiscrimination rules for certain statutory employee benefit plans. Under the agreement, a highly compensated employee who is a participant in any discriminatory statutory employee benefit plan is taxed generally only on the value of the discriminatory portion of the employer-provided benefit under the plan if such portion is timely reported.

The agreement (1) revises the nondiscrimination rules applicable to group-life term insurance plans and self-insured accident or health plans; (2) extends those rules to insured accident or health

plans; (3) establishes a new nondiscrimination test applicable to dependent care assistance plans; (4) applies the uniform definition of highly compensated employee, employer, and compensation generally applicable under the nondiscrimination rules for qualified plans; (5) permits satisfaction of the nondiscrimination tests on a controlled group, line of business, or operating unit basis; and (6) contains a special transition rule for certain dispositions or acquisitions of a business. Present-law concentration tests would continue to apply. Educational assistance and group legal services are not subject to the new nondiscrimination rules because the exclusions for those benefits are scheduled to expire, under the agreement, before the effective date of the new nondiscrimination rules.

Under the new nondiscrimination tests, employee benefit plans are subject to eligibility tests and a benefits test, applicable to each type of benefit. In applying the tests to health plans, employees with other health coverage can be disregarded, and family health coverage can be tested separately. In the case of group-life term insurance, the nondiscrimination rules can be applied to the value of coverage provided, expressed as a percentage of compensation (with the same cap on includible compensation applicable to qualified plans). Generally, different types of benefits can be aggregated for purposes of satisfying the benefits test, except that health plans must satisfy the benefits test without aggregation with other types of plans.

Under the conference agreement, benefits provided under a cafeteria plan are generally subject to the new nondiscrimination rules. In addition, the present-law cafeteria plan availability test continues to apply.

Under the conference agreement, full-time life insurance salesmen can participate in cafeteria plans, and employees of educational organizations may elect post-retirement life insurance coverage under a cafeteria plan. The agreement also provides that salary reduction under cafeteria plans is excluded from the FICA and FUTA wage bases.

The nondiscrimination rules are generally effective for the later of: (1) plan years beginning after December 31, 1987, or (2) the earlier of plan years beginning at least three months following the issuance of Treasury regulations or after December 31, 1988.

2. Deductibility of health insurance costs of self-employed individuals

The conference agreement provides a deduction for 25 percent of the amounts paid for health insurance for a taxable year on behalf of a self-employed individual and the individual's spouse and dependents. No deduction is allowable to the extent the deduction exceeds the self-employed individual's net earnings from self employment (sec. 1402(a)) for the taxable year. In addition, no deduction is allowable for any taxable year for which the self-employed individual is eligible to participate (on a subsidized basis) in a health plan of an employer of the self-employed individual or such individual's spouse.

The provision is effective for taxable years beginning after December 31, 1986, and before Januray 1, 1990.

3. Exclusions for educational assistance programs, qualified group legal services, and dependent care assistance programs

The conference agreement retroactively extends the exclusions from gross income for educational assistance and group legal services and the tax exemption for qualified group legal services organizations for two years through 1987.

In addition, the agreement increases the cap on annual excludable educational assistance benefits to $5,250 from $5,000.

The provisions generally are effective (1) in the case of educational assistance benefits, for taxable years beginning after December 31, 1985, and (2) in the case of group legal services benefits and the tax exemption for qualified group legal services organizations, for taxable years ending after December 31, 1985. A special rule is provided for group legal services benefits provided under a cafeteria plan.

The conference agreement imposes a $5,000 cap ($2,500 for a married individual filing separately) on the exclusion for dependent care assistance. The provision is effective for taxable years beginning after December 31, 1985.

4. Faculty housing

The conference agreement provides generally that, for Federal tax purposes, the fair market value of the use (on an annualized basis) of qualified campus lodging furnished by, or on behalf of, a school, college, or university is to be treated as not greater than five percent of the appraised value for the lodging, but only if, under Treasury regulations, an independent appraisal of the fair market value is obtained by a qualified appraiser.

The provision is effective for taxable years or periods beginning after December 31, 1985.

5. Health benefits for retirees

The Senate provision is not included in the conference agreement.

6. Accrued vacation pay

Under the conference agreement, the special rule allowing a deduction for additions to a reserve account for vacation pay (sec. 463) is limited to the vacation pay that is paid during the current taxable year or within 8-1/2 months after the close of the taxable year of the employer with respect to which the vacation pay was earned by the employees.

The provision is effective for taxable years beginning after December 31, 1986.

G. Employee Stock Ownership Plans (ESOPs)

1. Repeal of employee stock ownership tax credit

The conference agreement repeals the special payroll-based ESOP tax credit for compensation paid or accrued after December 31, 1986. A special transition rule is provided.

2. Certain additional tax benefits relating to ESOPs

The conference agreement permits an exclusion from the gross estate of 50 percent of the qualified proceeds from a qualified sale of employer securities. Under the conference agreement, a qualified sale means any sale of employer securities (within the meaning of sec. 409(l)) by the executor of an estate to (1) an ESOP, or (2) an eligible worker-owned cooperative (as defined in sec. 1042(c)(2)). The provision is effective for sales after the date of enactment and before January 1, 1992.

Under the conference agreement, the deduction for dividends paid on ESOP stock is expanded to apply to dividends that are used to repay ESOP loans used to acquire the stock on which the dividends are paid. The provision is effective for taxable years beginning after the date of enactment.

The conference agreement extends the 50-percent exclusion for interest paid on securities acquisition loans (sec. 133) to refinancing of loans used to acquire employer securities after May 23, 1984. In addition, the conference agreement modifies the exclusion in two respects. First, the conference agreement provides that the exclusion is also available with respect to a loan to a corporation to the extent that, within 30 days, employer securities are transferred to the plan in an amount equal to the proceeds of the loan and such contributions are allocable to participants' accounts within one year after the date of the loan. Second, under the conference agreement, a lender eligible for the interest exclusion is amended to include a regulated investment company (as defined in sec. 851). These modifications are effective for loans used to acquire employer securities after the date of enactment.

3. Changes in qualification requirements relating to ESOPs

Under the conference agreement, additional requirements are provided for any ESOP. These additional qualification requirements (1) permit distributions upon termination of an ESOP, (2) modify the distribution and put option requirements, (3) modify the special limits on allocations of contributions to an ESOP to conform the definition of highly compensated employee to the new definition provided for qualified plans generally, (4) require stock bonus plans to satisfy the put option requirements applicable to ESOPs, (5) permit an eligible plan participant to direct the ESOP trustee to diversify a portion of the participant's account balance, (6) require the value of employer securities to be determined by an independent appraiser, and (7) eliminate, with respect to ESOPs maintained by certain closely held newspaper publishers, the pass-through voting requirements.

The provision permitting distributions upon plan termination generally is effective for termination distributions made after December 31, 1984. The distribution requirements and the extension of the put option requirement to stock bonus plans are effective for distributions attributable to stock acquired after December 31, 1986. The modifications of the put option requirement are effective with respect to stock acquired after the date of enactment. The

modified definition of highly compensated employees is effective for years beginning after December 31, 1988. The diversification requirements are effective with respect to ESOPs adopted after December 31, 1986, and contributions made to an existing ESOP after December 31, 1986.

Title XII. Foreign Tax Provisions

A. Foreign Tax Credit

1. Foreign tax credit limitation

The overall foreign tax credit limitation of present law is retained. The separate limitation for interest income is replaced with separate limitations for passive income, shipping income, and banking income. Passive income includes certain categories of income described under the anti-tax haven rules (subpart F).

The conference agreement adopts a de minimis rule only for controlled foreign corporations. Coordination rules are provided for controlled foreign corporations that have no subpart F inclusions because they satisfy the subpart F de minimis rule. The subpart F de minimis rule is amended so that it applies if gross foreign base company income is less than the lesser of (1) five percent of gross income or (2) $1 million.

The conference agreement contains a modified high tax kickout.

Taxable interest payments from controlled foreign corporations to related persons consist of passive income to the extent of the payor's passive income (computed prior to the operation of subpart F). There is a separate foreign tax credit limitation for each noncontrolled foreign corporation that pays dividends eligible for deemed paid foreign tax credit (with separate treatment for amounts attributable to high withholding tax interest). Interest received from noncontrolled foreign corporations is treated as passive income. Rents and royalties received from noncontrolled foreign corporations are treated as passive or active without reference to look-through rules. Interest earned in connection with export activities of the taxpayer or a related person is not subject to the banking limitation or the high withholding tax limitation described below. These provisions are effective for taxable years beginning after 1986, subject to certain transitional relief.

2. Credit for high withholding taxes on interest

Foreign gross withholding taxes on interest that are at least five percent of the gross amount are subject to a separate foreign tax credit limitation unless the loan is to finance exports of the taxpayer or related person. This provision is generally effective for taxes paid in taxable years beginning after 1986, but transitional relief is provided.

3. Deemed-paid credit

The deemed paid credit for a U.S. corporation's share of foreign taxes paid by a foreign corporation is determined with respect to the foreign corporation's multi-year pool of accumulated earnings and profits. Earnings and profits generally are computed in the same manner for actual distributions as they are now for subpart F

inclusions. These rules are generally effective for earnings and profits accumulated in taxable years beginning after 1986.

4. Effect of foreign and U.S. losses on foreign tax credit

Foreign source losses reduce all types of foreign source income before reducing U.S. source income. U.S. losses reduce categories of foreign income pro rata. This provision applies to losses incurred in taxable years beginning after 1986.

5. Subsidies

The conference agreement clarifies that foreign taxes that are rebated directly or indirectly are not creditable. This provision applies to taxable years beginning after 1986.

6. Carrybacks

Foreign tax credits that are currently unusable only because of the bill's rate reductions cannot be carried back for use in higher-rate taxable years.

B. Source Rules

1. Income from purchase and sale of inventory-type property

Present law generally is retained for U.S. persons (i.e., the title passage rule), while income earned by a foreign person attributable to a fixed place of business within the United States is U.S. source. A Treasury study will evaluate the title passage rule.

2. Income from intangible property

With respect to royalty income, the conference agreement retains the place-of-use source rule of present law. With respect to sales income, unless the amount received is contingent on the use of the intangibles, the source is generally in the country of residence of the seller. However, for U.S. persons, sales involving a foreign office will yield foreign source income (if the income is subject to at least a 10-percent foreign tax). In addition, income earned by a foreign person attributable to a fixed place of business within the United States is U.S. source.

3. Income from sale of other personal property

Under the conference agreement, recapture income derived from sales of personal property used by the seller in a business is sourced where deductions with respect to such property previously offset income. Income in excess of those deductions is sourced according to present law. Income derived from sales of other personal property, including passive investment property, is generally sourced in the country of residence of the seller. However, for U.S. persons, sales involving a foreign office will yield foreign source income (if the income is subject to at least a 10-percent foreign tax). Certain sales of corporate stock are sourced in the country where the corporation whose stock is sold did most of its business. In addition, income earned by a foreign person attributable to a fixed place of business within the United States is U.S. source.

4. Transportation income

The conference agreement sources transportation income from United States-foreign routes as 50-percent U.S. source income and 50-percent foreign source. (Present law generally treats most transportation income earned on such routes as foreign source income.) The special U.S. sourcing rule for income and expenses associated with vessels or aircraft constructed in the United States and leased to U.S. persons is repealed. The conference agreement also repeals a similar rule for transportation income earned in leasing certain aircraft used on United States-U.S. possessions routes. The repeal of both special rules is subject to a grandfather rule.

The reciprocal tax exemption for foreign persons' shipping and aircraft income is available only if a foreign person's country of residence gives U.S. persons an equivalent foreign tax exemption. Eligibility for the reciprocal exemption is extended to bareboat charter income. In addition, a four-percent gross basis tax is generally imposed on U.S. source transportation income of foreign persons not resident in countries that provide reciprocal tax exemptions to U.S. carriers.

5. Other offshore income and income earned in space

The conference agreement generally sources other offshore income and income earned in space in the recipient's country of residence. Certain communications income is sourced half in the place of transmission, half in the place of reception.

6. Dividend and interest income

In general, interest and dividend income paid by a U.S. corporation that earns more than 80 percent of its income from an active foreign business (an "80/20" company) is foreign source to the extent that the company's income is derived from foreign sources. Dividends paid to U.S. persons are U.S. source, however. A similar rule applies to interest paid by "80/20 individuals". The conference agreement also restructures certain interest income exemptions.

7. Allocation of interest and other expenses (other than research and development)

The conference agreement generally requires corporate members of affiliated groups to allocate all expenses between U.S. and foreign income on a consolidated group basis. Certain corporations that cannot join in filing consolidated returns can continue to allocate expenses on a separate company basis. Authority to require netting of interest expense and interest income is provided for in limited cases. The asset method of allocating interest expense is modified and the optional gross income method is eliminated. Tax-exempt income and assets are not taken into account for purposes of allocating expenses. The new interest allocation rules will be phased in over three to five years in certain cases. Other transitional relief is provided.

8. Allocation of R&D expenses

For one year, taxpayers are to allocate half the expenses for U.S.-performed R&D to U.S. source income, and the other half on

the basis of sales or gross income. (The Statement of Managers will indicate that legislative intervention is appropriate until the Treasury Department resolves the incompatibility between the suspended Treasury regulations and foreign tax systems.) After one year, starting with taxable years beginning after August 1, 1987, a suspended Treasury Regulation generally requiring allocation on the basis of sales or gross income will take effect.

9. Effective date

The rules governing the source of income are generally effective for taxable years beginning after 1986, although the bill provides certain transitional relief. Certain rules applicable to foreign taxpayers apply to transactions occurring after March 18, 1986.

C. Taxation of U.S. Shareholders of Foreign Corporations

1. Tax haven income generally

Interest, dividends, and gains received by banks and insurance companies (with an export finance exclusion), insurance income, amounts equivalent to interest, income earned in space or outside any country, and net gains from transactions in commodities, foreign currency, and certain other property generally are taxed currently if earned by controlled foreign corporations. Certain exceptions to the Code's rules that currently tax certain "tax-haven" income of foreign subsidiaries of U.S. shareholders are repealed, including the exclusion for reinvested shipping income. The subjective tax avoidance safe-harbor rule is replaced with an objective test. To coordinate the subpart F rules and the passive basket rules, prior year deficits in earnings and profits and other companies' deficits in earnings and profits do not reduce subpart F income. Income that is recaptured under the foreign loss recharacterization rule is subpart F income in accordance with the character of the original income requiring recapture.

2. Determination of U.S. control of foreign corporations

The U.S. ownership requirement for imposition of the subpart F rules is amended. For the subpart F rules to apply to a foreign corporation, more than 50 percent of the vote or value (not merely vote) of that corporation must belong to 10-percent U.S. shareholders. Similarly, for the foreign personal holding company rules to apply, more than 50 percent of the vote or value of a foreign corporation must be owned by five or fewer U.S. individuals.

3. De minimis tax haven income rule

Present law is amended to reduce the 10 percent of gross income threshold for foreign base company income to the lesser of $1 million or five percent of gross income.

4. Possessions-chartered corporations

The exception in the subpart F rules for possessions-chartered corporations is repealed subject to a transition rule.

5. Application of accumulated earnings tax (AET) and personal holding company (PHC) tax to foreign corporations

Present law is amended to allow foreign corporations a net capital gain deduction for purposes of calculating the AET or PHC tax only if the gains are taxed by the United States at the corporate level. This provision applies to transactions occurring after March 1, 1986.

6. Deduction for dividends received from foreign corporations

The deduction for dividends received from foreign corporations is modified to extend to dividends from corporations earning either any amount of U.S.-connected income or dividends from U.S. subsidiaries. The deduction is limited to 10-percent U.S. corporate shareholders, and is to be calculated on a net basis. Any amount eligible for the deduction is to be treated as U.S. source. Rules are provided to prevent double benefits.

7. Delayed effective date for 1984 amendment to earnings and profits rules

The conference agreement extends through 1987 the delay in the application to foreign corporations of the 1984 Act's amendments to the earnings and profits rules relating to installment sales.

8. Effective date

Except as indicated above, the conference agreement's rules applicable to income earned through foreign corporations are generally effective for taxable years beginning after 1986.

D. Special Tax Provisions for U.S. Persons

1. Possession tax credit

The conference agreement retains the existing possession tax credit with certain modifications. The optional cost sharing method of allocating intangible income is changed to require that the cost sharing payment be determined as the greater of (1) 110 percent of the payment determined under present law or (2) an arm's-length royalty. The conference agreement also requires an increase in the cost sharing payment (20 percent above the present law payment), and makes a technical correction thereto, for purposes of the 50/50 profit split method. The active income test for possession corporation status is increased from 65 to 75 percent. Income from loans for active business assets and development projects in qualified Caribbean Basin Initiative countries is eligible for U.S. tax exemption. Compliance rules are provided, and a good faith effort to implement Puerto Rico's twin plan+ program is expected. In addition, the requirement that funds be received in a possession to qualify for the section 936 credit does not apply to active business income from an unrelated party. Finally, section 936 treatment is extended to the U.S. Virgin Islands. These provisions are generally effective for taxable years after 1986.

2. Taxation of certain employees in Panama

The conference agreement clarifies that the Panama Canal Treaty and its implementing agreements do not exempt U.S. tax-

payers from U.S. tax. The conference agreement provides that Panama Canal Commission and Defense Department employees are entitled to certain tax-free allowances like those available for State Department employees. The agreement's clarification of the effect of the Panama Canal treaty is effective for all taxable years. The rule concerning taxation of employees' allowances applies for taxable years beginning after 1986.

3. Exclusion for private sector earnings of Americans abroad

The conference agreement reduces the maximum annual exclusion for foreign earned income of Americans working abroad, from the present $80,000 to $70,000. It denies this exclusion to Americans in foreign countries to which travel is prohibited by law. These provisions are effective for taxable years beginning after 1986.

4. Transfers of intangibles to related parties outside of the U.S

The payment for intangibles received from foreign corporations by related U.S. persons shall be commensurate with the actual income attributable to the intangible. These rules generally apply to taxable years beginning after 1986, with respect to intangibles transferred after November 16, 1985.

5. Compliance provisions applicable to U.S. persons resident abroad

The conference agreement requires that passport and green card applicants complete an IRS information return. It also requires withholding on pension payments to persons with foreign addresses. These provisions apply to taxable years beginning after 1986.

6. Foreign investment companies (FICs)

Present law is amended to require either payment of an interest charge on eventual recognition of income earned by U.S. investors through passive FICs (subject to a gain limitation) or current recognition, and to apply these rules to U.S. investors irrespective of the degree of aggregate U.S. ownership. This provision is effective for taxable years beginning after 1986.

E. Treatment of Foreign Taxpayers

1. Branch profits tax

The branch profits tax proposed by the President as a substitute for the present dividend withholding tax is generally adopted. The conference agreement generally retains present law (but with a reduction of present law's 50 percent income threshold to 25 percent) when a treaty allows present law to apply but would not allow a branch profits tax to apply. The withholding tax on interest is based on the deduction taken by the branch, with amounts deducted in excess of actual branch payments treated as interest paid to a home country parent. The conference agreement does not override treaties, including those regarding dividend and interest payments, except in treaty shopping cases. These rules are effective for taxable years beginning after 1986.

2. Retain character of effectively connected income

The conference agreement treats income or gain as effectively connected with a U.S. trade or business if it is attributable to a different taxable year and would have been so treated if it had been taken into account in the other year. This rule applies to taxable years beginning after 1986.

3. Tax-free exchanges by expatriates

The tax-avoidance expatriate rules under present law are applied to gains on the sale of property the basis of which was determined by reference to U.S. property. This rule applies to sales or exchanges of property received in exchanges after September 25, 1985.

4. Excise tax on insurance premiums paid to foreign insurers

The conference agreement does not contain the excise tax provision of the House bill. Instead, the conference agreement adopts a provision that imposes current tax on each U.S. person who owns stock in any 25-percent or more U.S.-owned foreign insurance company with respect to income from insuring risks of U.S. stockholders and related parties, whatever the degree of ownership of the U.S. stockholder. An exception applies to insurance companies whose stock is publicly and freely traded. Similar rules apply to mutual companies. This income is separately boxed. The provision is effective for years beginning after 1986. Treasury is to study the impact of treaty waivers of the excise tax on the domestic reinsuance industry.

5. Reporting by foreign controlled corporations

The conference agreement requires foreign-controlled foreign corporations doing business in the United States and foreign-controlled U.S. corporations to report transactions with all related persons, whether or not a corporation. This provision is effective for taxable years beginning after 1986.

6. Foreign investors in U.S. partnerships

The agreement requires that domestic and foreign partnerships engaged in a U.S. trade or business withhold on certain distributions to foreign partners. The agreement clarifies that the withholding requirement applies to all distributions to a foreign partner when 80 percent or more of a partnership's income is U.S. business income (with a rule that requires withholding only on the percentage of U.S. business income in cases of less U.S. business income), and coordinates this withholding provision with existing withholding provisions so as to avoid duplicative withholding. This provision is effective for taxable years beginning after 1986.

7. Income of foreign governments

The agreement provides that the tax exemption for foreign governments applies only to investment income. It provides that payments from a controlled entity that engages in U.S. trade or business are not investment income, so they are taxable. The agree-

ment does not change the rules that apply to international organizations. This provision is effective on July 1, 1986.

8. Transfer prices for imports

Importers cannot claim a transfer price for income tax purposes that is higher than is consistent with the value they claim for customs purposes. This provision applies to transactions entered into after March 18, 1986.

9. Dual resident companies

Losses of a U.S. corporation that offset a foreign corporation's foreign tax cannot offset any income of any other corporation for U.S. tax purposes. This provision applies to taxable years beginning after 1986.

10. Earnings stripping: interest paid to related tax-exempt parties

The agreement does not contain the Senate provision limiting the deduction for net interest paid or accrued to related tax-exempt parties.

11. Definition of resident alien

In determining whether an alien individual is a U.S. resident for U.S. income tax purposes under the 1984 Act's substantial presence test, days in which a professional athlete is present in the United States competing in certain charitable sports events will not be counted. This provision applies to periods after the bill's date of enactment.

F. Foreign Currency Exchange Gain or Loss

The tax treatment of exchange gain or loss, including character, source, and timing, is clarified. Generally, exchange gain or loss arises if the exchange rate fluctuates between the date an item is taken into account for tax purposes and the date it is paid. In general, the conference agreement provides that exchange gain or loss is ordinary in nature. To the extent provided by regulations, a special rule will require a taxpayer to recognize gain or loss currently with respect to an item that is "hedged" by an offsetting position (e.g., a foreign currency futures contract). All business entities that account for foreign operations in a foreign currency are generally required to use a profit and loss translation method. For purposes of the direct foreign tax credit and the indirect foreign tax credit, a foreign tax is generally calculated on the basis of the exchange rate in effect on the date paid (the *Mauvais Ami* rule).

These rules are effective for taxable years beginning after 1986.

G. Tax Treatment of Possessions

1. U.S. Virgin Islands

The Virgin Islands will continue to use the mirror code. The Virgin Islands inhabitant rule is repealed for all open years (except as to V.I. income) with a targeted exception. To be exempt from U.S. withholding tax, 65 percent of a Virgin Islands corporation's

income must be effectively connected with a trade or business in a possession or in the United States. Anti-abuse rules are provided.

2. Guam, the Commonwcath of the Northern Mariana Islands (CNMI), and American Samoa

After 1986, full authority will be granted to Guam and the CNMI to determine their own income tax laws (as American Samoa currently does). To avoid U.S. withholding tax, 65 percent of a possession corporation's income must be effectively connected with a trade or business in a possession or in the United States. Anti-abuse rules are provided.

3. Effective date

The bill's rules coordinating United States and possessions taxation generally apply to taxable years beginning after 1986, or as soon as the applicable possession enters into an implementation agreement with the United States in tax matters.

Title XIII. Tax-Exempt Bonds

A. Tax-Exempt Bond Provisions

1. Bonds to finance general governmental operations

The conference agreement retains the tax-exemption for interest on State and local government bonds used to finance traditional governmental operations. These bonds may continue to be issued without regard to many of the limitations applicable to bonds for persons other than States and local governmental units.

Interest on bonds to provide conduit financing for persons other States and local governmental units (collectively referred to as "private activity bonds") is taxable unless a specific exception is provided in the Code. A bond generally is viewed as a private activity bond if—

(1)(a) an amount equal to or exceeding 10 percent of the proceeds is to be used in a trade or business of a person or persons other than a State or local governmental unit and (b) direct or indirect payments equaling or exceeding 10 percent of the debt service on the bonds are made with respect to such trade or business use, or

(2) an amount equal to or exceeding the lesser of five percent or $5 million of bond proceeds is to be used to make or finance loans to persons other than State or local governments.

(In the case of bonds to finance output facilities, private use and payments with respect to that use must total less than the lesser of 10 percent or $15 million per facility.)

In addition, the conference agreement provides that private use of governmental bond proceeds in excess of five percent must be related to a governmental facility also being financed with the bonds. The private use is treated as related only if the financing provided for the private use is proportional to the total financing provided by the issue for the related governmental facility.

2. Exceptions for certain private activity bonds

Present law includes several exceptions permitting tax-exemption for interest on bonds for private activities. These exceptions are for (a) bonds for section 501(c)(3) organizations; (b) industrial development bonds (IDBs); (c) student loan bonds issued in connection with certain Department of Education guarantees; (d) qualified mortgage bonds and qualified veterans' mortgage bonds; (e) certain bonds issued under non-Code statutes enacted before 1983; and (f) private loan bonds issued pursuant to certain specifically described State programs.

The conference agreement continues many of the exceptions of present-law permitting tax-exempt financing for persons other than

States and local governmental units.[1] First, interest on qualified 501(c)(3) bonds remains tax-exempt. Second, interest on bonds to finance certain exempt facilities is tax-exempt: airports, docks and wharves, mass commuting facilities, certain facilities for the furnishing of water, sewage and solid waste disposal facilities, qualified residential rental projects,[2] local district heating and cooling facilities, facilities for the local furnishing of electricity or gas, and certain hazardous waste disposal facilities. Third, interest on qualified redevelopment bonds, small-issue bonds,[3] and student loan bonds (including supplemental student loan bonds) is tax-exempt. Finally, interest on qualified mortgage bonds [4] and qualified veterans' mortgage bonds is tax-exempt. (The conference agreement also retains the option for States and local governments to elect to exchange qualified mortgage bond authority and issue mortgage credit certificates, at an increased exchange rate of 25 percent.)

3. State volume limitation

Present law provides three separate State volume limitations for (a) IDBs and student loan bonds, (b) qualified mortgage bonds, and (c) qualified veterans' mortgage bonds. Certain types of IDBs and bonds for section 501(c) organizations are not subject to State volume limitations.

The conference agreement provides a single State volume limitation for exempt-facility bonds, small-issue bonds, qualified redevelopment bonds, student loan bonds, and qualified mortgage bonds. In addition, the private use portion (in excess of $15 million) of governmental bonds is subject to the new limitation unless specifically excluded from the cap. The new volume limitation for each State is equal to the greater of $75 per resident or $250 million per annum until December 31, 1987, after which date it is reduced to $50 per resident or $150 million per annum. There are no special set-asides under this volume limitation. In general, the new volume limitation is administered in a manner similar to the present-law volume limitations on IDBs and student loan bonds and on qualified mortgage bonds. Thus, a Federal allocation formula is provided, subject to being overridden by gubernatorial proclamation (effective for an interim period only) or by State legislation.

Qualified 501(c)(3) bonds and exempt-facility bonds for governmentally owned solid waste disposal facilities and for governmentally owned airports and docks and wharves are not subject to the

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[1] The agreement continues the present-law exceptions for private activity bonds issued as part of the Texas Veterans' Land Bond Program and the Oregon Renewable Source Energy Program, and adds a new exception for a limited amount of bonds issued as part of the Iowa Industrial New Jobs Training Program.

[2] Bond-financed residential rental projects must satisfy new continuous compliance and annual certification requirements. Additionally, owners of such projects must elect to satisfy one of two low-income occupancy requirements: 40 percent of the residential rental units occupied by individuals having incomes of 60 percent or less of area median income, or 20 percent of such units occupied by individuals having incomes of 50 percent or less of area median income. All income determinations are made with family-size adjustments.

[3] The sunset for small-issue bonds for manufacturing facilities is extended one additional year, through December 31, 1989. Additionally, issuance of these bonds for first-time farmers is treated as issuance for manufacturing. The present December 31, 1986, sunset is retained for small-issue bonds other than for manufacturing facilities.

[4] The sunset date for qualified mortgage bonds is extended one additional year, through December 31, 1988.

new volume limitation. Qualified veterans' mortgage bonds remain subject to their present-law volume limitation.

4. Arbitrage and related restrictions

Interest on arbitrage bonds is taxable under present law. Arbitrage bonds are bonds more than a minor portion of the proceeds of which are invested in materially higher yielding, taxable obligations. IDBs and qualified mortgage bonds are subject to additional arbitrage restrictions that require rebate to the Federal Government of arbitrage profits on obligations unrelated to the purpose of the borrowing and the amount of bond proceeds that may be invested in such obligations is restricted.

The conference agreement makes several modifications to the arbitrage and related restrictions applicable to all tax-exempt bonds, including the following:

(1) Rebate requirements, similar to the present-law IDB rules, are extended to all tax-exempt bonds. (Mortgage revenue bonds are subject to the present-law qualified mortgage bond rules.) An exception is provided for bonds to finance operations of certain small general purpose governmental units, and a special safe-harbor rule is provided for use in determining the amount of the rebate on so-called tax- and revenue-anticipation notes.

(2) Yield on all tax-exempt bonds is determined under the arbitrage restrictions using the original issue discount rules of the Code (i.e., the *State of Washington* case is reversed).

(3) New temporary period restrictions are imposed on pooled financings and on advance refundings.

(4) The minor portion of bond proceeds which may be invested at unrestricted yield is limited to an amount equal to the lesser of five percent or $100,000. The amount of actual bond proceeds that may be used to fund a debt service reserve fund is limited to 10 percent unless the Treasury approves a greater amount for a specific issue. As under present law, amounts deposited in such reserve funds may be invested without regard to arbitrage yield restrictions (but are subject to the rebate requirement) up to the allowed 10 percent amount.

(5) Certain letter of credit fees (like bond insurance premiums) are treated as interest expense to the extent that the fees represent a charge for transfer of credit risk.

(6) The Treasury Department is authorized to waive loss of tax-exemption for certain late or erroneous rebate payments, if the error is not due to willful disregard of the rebate requirement.

(7) Restrictions are placed on investment of bond proceeds in deferred compensation arrangements and other investment type property.

Under the conference agreement, advance refundings are permitted for governmental and qualified 501(c)(3) bonds, subject to a limitation of two advance refundings per issue (one advance refunding in the case of bonds originally issued after 1985) and various other restrictions.

5. Changes in use of bond-financed facilities

The conference agreement provides that in addition to loss of tax-exemption on bond interest where provided under present law,

certain amounts paid in connection with bond-financed property that ceases to be used in a use qualifying for tax-exempt financing may not be deducted for Federal income tax purposes. In general, the nondeductible amount is equal to the interest (or the equivalent thereof) paid on bond-financed loans.

6. Miscellaneous requirements

The conference agreement provides that, for most private activity bonds, at least 95 percent of the proceeds must be spent for the exempt purpose of the borrowing. In the case of Federally guaranteed student loan bonds, this amount is 90 percent.

The conference agreement generally limits the amount of costs of issuance that may be paid from private activity bond proceeds to two percent and further provides that amounts paid for costs of issuance are not treated as spent for the exempt purpose of the borrowing (i.e., are not counted in determining whether the 95 percent, etc. requirement, described above, is satisfied).

The public approval requirements that currently apply to IDBs are extended to all private activity bonds. Additionally, the restriction on maturity of IDBs is extended to qualified 501(c)(3) bonds, and qualified 501(c)(3) bonds (other than hospital bonds) are subject to a $150 million per institution limit on outstanding bonds. Certain bond-financed facilities are also required to be owned by or on behalf of a governmental unit (in the case of qualified 501(c)(3) bonds, a governmental unit or section 501(c)(3) organization).

The conference agreement extends to all tax-exempt bonds information reporting requirements similar to the requirements that presently apply to IDBs, student loan bonds, qualified 501(c)(3) bonds, and mortgage revenue bonds.

Under the conference agreement, the amount of depreciable farm property which may be financed with small-issue tax-exempt bonds is limited to $250,000 per person (including related persons).

7. Effective dates

The provisions of the conference agreement generally apply to all bonds issued after August 15, 1986. In the case of provisions and bonds covered under the Joint Statements on Effective Dates of March 14, 1986, and July 17, 1986, the conference agreement is effective for bonds issued on or after September 1, 1986 (3:00 p.m. E.D.T., July 17, 1986, in the case of application of the arbitrage rebate requirement to certain pooled financings.) Certain arbitrage and related restrictions apply to bonds issued after December 31, 1985 (September 25, 1985, in the case of so-called "pension bonds"). Transitional exceptions are provided for certain amendments included in the conference agreement.

B. General Stock Ownership Corporations (GSOCs)

The conference agreement repeals the Code provisions relating to General Stock Ownership Corporations (GSOCs) as deadwood, effective January 1, 1984.

Title XIV. Trusts and Estates; Minor Children; Gift and Estate Taxes; Generation-Skipping Transfer Tax

A. Income Taxation of Trusts and Estates

1. Tax rate schedule

The rate schedule applicable to the retained income of trusts and estates is compressed as compared with the rates applicable to individuals. The first $5,000 of taxable income of trusts and estates is taxed at 15 percent, with any excess taxed at 28 percent. The benefit of the 15-percent rate is phased out between $13,000 and $26,000 of taxable income.

2. Grantor trust rules

Under the conference agreement, the income of a trust generally is taxed to its grantor if the trust corpus will revert to the grantor or the grantor's spouse at any time. An exception is provided where the trust may revert only after the death of the income beneficiary of the trust who is a lineal descendant of the grantor.

This provision applies to transfers in trust made after March 1, 1986, with an exception for certain trusts created pursuant to a binding property settlement entered into before March 1, 1986.

3. Taxable years of trusts

The conference agreement requires that existing and newly created trusts, other than wholly charitable trusts, adopt a calendar year as their taxable year. This provision applies for taxable years beginning after December 31, 1986.

4. Trusts and estates to make estimated payments of income tax

The conference agreement requires that new and existing estates after their second taxable year and trusts pay estimated tax in the same manner as individuals. Also, the conference agreement repeals the rules that permit estates to pay tax over four equal installments. This provision is effective for taxable years beginning after December 31, 1986.

B. Unearned Income of Children Under Age 14

Under the conference agreement, all of the unearned income of a child under age 14 in excess of $500 is taxed to the child at the top marginal rate of his or her parents. This rule applies to any taxable income of the child reduced by the $500 of standard deduction that the child may allocate to unearned income. Thus, the provision generally applies only to unearned income of the minor child in excess of $1,000.

This provision generally is effective for taxable years beginning after December 31, 1986.

C. Gift and Estate Taxes

1. Filing information for estate tax current use valuation elections

Where an executor of an estate of an individual dying before 1986 elected current use valuation on a timely filed estate tax return by providing substantially all the information elicited by the return form, the executor will have an additional 90 days, after being notified by the IRS, to supply any missing information. This provision is effective on enactment of the bill, with a special targeted transitional exception.

2. Gift and estate tax deductions for certain conservation easement donations

Deductions for contributions of certain interests in real property to charitable organizations, to the United States, or to a State or local governmental unit are allowed for Federal gift and estate tax purposes even if the contributions do not meet the requirement for deductibility for Federal income tax purposes that the contributions be for conservation purposes.

This provision is effective for contributions made after December 31, 1986. A targeted transition rule is provided for certain contributions to the Acadia National Park in Maine.

3. Special relief for the Estate of James H. W. Thompson

Special relief is provided for certain Thai artifacts that were indirectly contributed by James H. W. Thompson to a charitable organization for the benefit of the Thai people.

D. Generation-Skipping Transfer Tax

The conference agreement amends the present generation-skipping transfer tax to impose a flat-rate tax both on transfers involving a sharing in benefits by more than one generation and on direct transfers that skip generations. A $1 million per transferor specific exemption is provided, with transfers in excess of that amount being subject to tax at a rate equal to the maximum gift and estate tax rate. In addition, the conference agreement provides an additional exemption of $2 million per donee against the tax on direct skips to grandchildren, until January 1, 1990.

The provision is effective generally for testamentary transfers made after the date of enactment and for inter vivos transfers made after September 25, 1985.

Title XV. Compliance and Tax Administration

A. Penalties

1. Penalty for failure to file information returns or statements

The conference agreement consolidates the present-law penalty for failure to file an information return with the IRS and the present-law penalty for failure to supply a copy of the information return to the taxpayer. The conference agreement also provides a new penalty for failure to include correct information on an information return. This applies to information returns the due date for which is after December 31, 1986.

2. Increase in penalty for failure to pay tax

The conference agreement increases the penalty for failure to pay taxes from one-half of one percent under present law to one percent after the IRS notifies the taxpayer that the IRS will levy upon the assets of the taxpayer. This applies to amounts assessed after December 31, 1986.

3. Negligence and fraud penalties

The conference agreement expands the scope of the negligence penalty by making it applicable to all taxes under the Code. The conference agreement also provides that failure to report on a tax return any amount reported on an information return is considered negligence in the absence of clear and convincing evidence to the contrary. The conference agreement modifies the fraud penalty by increasing the rate to 75 percent but applying the penalty only to the amount of the underpayment attributable to fraud. These provisions are effective for returns the due date of which is after December 31, 1986.

4. Penalty for substantial understatement of tax liability

The conference agreement increases the penalty for substantial understatement of tax liability from 10 to 20 percent of the amount of the underpayment of tax attributable to the understatement. This is effective for returns the due date of which is after December 31, 1986.

B. Interest Provisions

1. Differential interest rate

The conference agreement provides that the Government pays interest to taxpayers at the Federal short-term rate plus two percentage points, and that taxpayers pay interest to the Government at the Federal short-term rate plus three percentage points. These rates are adjusted quarterly, and apply to interest for periods after December 31, 1986.

2. Interest on accumulated earnings tax

The conference agreement provides that interest is imposed on underpayments of the accumulated earnings tax from the due date of the tax return with respect to which that tax is imposed. This applies to returns the due date for which (determined without regard to extensions) is after December 31, 1985.

C. Information Reporting Provisions

1. Real estate transactions

The conference agreement provides that the person responsible for closing a real estate transaction must provide an information report on the transaction. This is effective beginning January 1, 1987.

2. Persons receiving Federal contracts

The conference agreement requires Federal executive agencies to provide information reports on contracts that they enter. Reporting is required beginning January 1, 1987.

3. Royalties

The conference agreement modifies current information reporting requirements for royalties, effective January 1, 1987.

4. Taxpayer identification numbers of dependents

The conference agreement requires that any taxpayer claiming a deduction for a dependent who is at least five years old must report the taxpayer identification number of that dependent on that tax return, effective for returns required to be filed after December 31, 1987. Special rules are provided for religious groups exempt from social security taxes.

5. Modification of separate mailing requirement

The conference agreement modifies the separate mailing requirement for information reports on interest, dividends, patronage dividends, and royalties, effective for those returns required to be filed after December 31, 1986.

6. Tax-exempt interest

The conference agreement requires that tax-exempt interest be shown on tax returns filed after December 31, 1987.

7. State and local taxes

The conference agreement does not include the provision of the House bill requiring information reporting on state and local taxes.

D. Tax Shelters

1. Tax shelter user fee

The conference agreement does not include the tax shelter user fee provision of the Senate amendment.

2. Tax shelter registration

The conference agreement conforms the tax shelter ratio computation (used to determine whether a tax shelter must register with the IRS) more closely to the new tax rate schedule.

3. Tax shelter penalties

The conference agreement increases the penalties for failure to register a tax shelter, for failure to report a tax shelter identification number, and for failure to maintain lists of tax shelter investors, effective on the date of enactment.

4. Tax shelter interest

The conference agreement provides that sham or fraudulent transactions are subject to the increased rate of interest on underpayments of tax attributable to tax-motivated transactions. The conference agreement does not include the Senate provision increasing the rate of this interest.

E. Estimated Tax Payments

The conference agreement increases from 80 to 90 percent the proportion of the current year's tax liability that individual taxpayers must make as estimated tax payments in order to avoid the estimated tax penalty, effective for taxable years beginning after December 31, 1986. The conference agreement also requires that tax-exempt organizations subject to the unrelated business income tax and private foundations subject to the excise tax on their net investment income must make quarterly estimated payments of those taxes, effective for taxable years beginning after December 31, 1986.

F. Tax Litigation and Tax Court

1. Awards of attorney's fees in tax cases

The conference agreement extends permanently with several modifications the provision of present law authorizing awards of attorney's fees in tax cases. These modifications relate to the basis for such awards. The present-law burden of proof is unchanged.

2. Exhaustion of administrative remedies

The conference agreement provides that failure to exhaust administrative remedies is an additional basis for the Tax Court to impose a discretionary penalty.

3. Report to Congress on Tax Court inventory

The conference agreement provides that the Treasury and the Tax Court will report to Congress every two years on the Tax Court inventory.

4. Tax Court provisions

The conference agreement permits the Tax Court to impose a practice fee, clarifies that the Tax Court has jurisdiction over the penalty for failure to pay tax, clarifies that the Tax Court may obtain the assistance of U.S. Marshals, clarifies the pay and travel rules pertaining to Special Trial Judges, permits a judge to elect to

practice law after retirement and receive retirement pay, allows interlocutory appeals to be certified to the Court of Appeals, and conforms the survivor's annuity provisions to those applicable to the District Court.

G. Tax Administration Trust Fund

The conference agreement does not include the Senate provision establishing a Tax Administration Trust Fund.

H. Tax Administration Provisions

1. Suspend statute of limitations during prolonged dispute over third-party records

The conference agreement provides that, if a dispute between the IRS and a third-party recordkeeper is not resolved within six months, the statute of limitations is suspended until the issue is resolved.

2. Authority to rescind notice of deficiency

The conference agreement gives the IRS authority, if the taxpayer consents, to rescind a statutory notice of deficiency.

3. Authority to abate interest

The conference agreement gives the IRS the authority to abate interest attributable to error or delay by an IRS employee in performing a ministerial act.

4. Suspension of compounding when underlying interest is suspended

The conference agreement suspends the compounding of interest in circumstances in which the underlying interest on the deficiency is also suspended.

5. Additional exemption from levy

The conference agreement exempts from IRS levy military service disability benefits.

6. Rules applicable to forfeiture

The conference agreement conforms the rules in the Code applicable to forfeiture to the parallel Customs provisions.

7. Certain recordkeeping requirements

The conference agreement provides that IRS special agents are subject to the same income inclusion and recordkeeping rules that other law enforcement officers are with respect to use of an automobile.

8. Disclosure of return information to certain large cities

The conference agreement authorizes the Treasury to exchange tax return information with any city with a population exceeding two million that imposes an income or wage tax.

I. Modification of Withholding Schedules

The conference agreement requires employees to file revised withholding certificates by January 1, 1988. The conference agreement also instructs the Treasury Department to modify withholding schedules to better approximate actual tax liability under the conference agreement.

J. Report on Return-Free Tax System

The conference agreement requires the Treasury Department to report to the Congress on the potential for implementing a return-free tax system for individuals. The report is due not later than six months after enactment.

Title XVI. Exempt and Nonprofit Organizations

A. Exchanges and Rentals of Membership Lists of Certain Tax-Exempt Organizations

The conference agreement provides an exception from the unrelated business income tax, in the case of tax-exempt organizations eligible to receive tax-deductible charitable contributions, for income from exchanges or rentals of donor or member lists with or to other such tax-exempt organizations, effective for transactions occurring after the date of enactment.

B. Distribution of Low-Cost Articles by Charities

The conference agreement provides an exception from the unrelated business income tax, in the case of tax-exempt organizations eligible to receive tax-deductible charitable contributions, for income from certain distributions of low-cost articles incidental to soliciting charitable contributions, effective for distributions occurring after the date of enactment.

C. Expansion of Exception from Unrelated Business Income Tax for Qualified Trade Shows

The present-law exception from the unrelated business income tax for qualified trade show or convention activities of trade associations, labor unions, or agricultural organizations is expanded to cover (1) qualified trade shows or conventions at which suppliers to the sponsoring organization's members sell products or services, and (2) qualified trade show and convention activities of charitable organizations (sec. 501(c)(3)) and social welfare organizations (sec. 501(c)(4)), effective for taxable years beginning after the date of enactment.

D. Tax-Exempt Status for Certain Title-Holding Companies

The conference agreement adds a new category of section 501(c) tax-exempt organizations consisting of title-holding companies that have up to 35 related or unrelated tax-exempt organizations as shareholders or beneficiaries, if certain conditions are met. This provision is effective for taxable years beginning after December 31, 1986.

E. Exception to Membership Organization Deduction Rules

Membership organizations engaged primarily in the gathering and distribution of news to their members for publication are permitted to deduct expenses relating to the furnishing of goods and services to members from income whether or not derived from members, effective on the date of enactment.

F. Tax-Exempt Status for Technology Transfer Organization

Under the conference agreement, the Washington Research Foundation, an organization that transfers technology from universities and scientific research organizations to the private sector, is treated as a tax-exempt charitable organization, effective on the date of enactment.

Title XVII. Other Provisions

A. Targeted Jobs Tax Credit

The conference agreement extends the targeted jobs credit for three additional years, i.e., for first-year wages paid to individuals who begin work for the employer before 1989. Under the conference agreement, the credit for first-year wages is reduced from 50 percent to 40 percent; wages paid in the second year of a targeted individual's employment are not eligible for the credit; and the credit is not available if the employee works less than 90 days (14 days in the case of qualified summer youth employees) or 120 hours (20 hours in the case of qualified summer youth employees). These modifications to the credit apply with respect to individuals who begin work for the employer after 1985.

B. Collection of Diesel Fuel and Gasoline Excise Taxes

Diesel fuel tax.—Under the conference agreement, the diesel fuel excise tax for highway use may be imposed on the sale from a wholesaler to a retailer of the fuel (or by the manufacturer where the sale is direct to the retailer), at the election of a qualified retailer, effective for sales of diesel fuel for use in highway vehicles after the first calendar quarter beginning more than 60 days after the date of enactment of the bill.

Gasoline tax.—The present rules under which collection of the manufacturers excise tax may be deferred to the wholesale level are repealed, effective January 1, 1988. The Treasury is directed to study the incidence of evasion of the gasoline tax and to report to the Congress by December 31, 1986.

C. Social Security and FUTA Provisions

1. Allow ministers to reelect social security coverage

The conference agreement provides for a one-time irrevocable election back into social security coverage (and the self-employment tax) for ministers who had previously elected out on religious grounds, effective for taxable years beginning on or after the date of enactment.

2. FUTA for certain Indian tribes

FUTA taxes assessed against certain Indian tribes for the period of time they are refused unemployment compensation coverage by the State are excused. This provision is effective with respect to services performed before, on, or after the date of enactment, and before January 1, 1988.

3. Treatment of certain technical personnel

Section 530 of the Revenue Act of 1978 does not apply to services provided pursuant to an arrangement between the taxpayer and

another organization whereby the individual provided services as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work for such other organization, effective for services rendered after the date of enactment.

D. Tax Code Reference

The conference agreement enacts into law the Internal Revenue Code of 1986. That is, the conference agreement reenacts the provisions of the 1954 Code—as in effect on the date of enactment of the bill—together with amendments as made by the conference agreement. Under the conference agreement, no provision of the Internal Revenue title that was in effect on August 16, 1954 is to apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of the 1954 Code.

E. Miscellaneous Provisions

1. Foster care payments

The present-law exclusion for certain foster care payments is extended to cover such payments for care of adults as well as children, and is modified to eliminate the requirement of detailed recordkeeping, effective for taxable years beginning on or after January 1, 1987.

2. Rules for spouses of Vietnam MIAs

The conference agreement reinstates and makes permanent certain expired provisions relating to Vietnam MIAs, effective for taxable years beginning after 1982.

3. Exempt certain reindeer income from tax

The conference agreement provides that income derived directly from the sale of reindeer or reindeer products as provided in the Reindeer Industry Act of 1937 is exempt from Federal income taxation. This provision applies as if originally included in the related provision of the 1937 Act.

4. Certain quality control studies for AFDC and Medicaid

The conference agreement provides revised deadlines for a study to be conducted by the Department of Health and Human Services (HHS) and the National Academy of Sciences (NAS) of quality control measures in connection with the administration of the Aid to Families with Dependent Children and Medicaid programs, and for publication by HHS of regulations relating to such quality control measures.

Title XVIII. Technical Corrections

This title contains technical, clerical, conforming, and clarifying amendments to provisions enacted by the Tax Reform Act of 1984, the Retirement Equity Act of 1984, and other recently enacted tax legislation, as well as similar amendments to nontax provisions of the Deficit Reduction Act of 1984.

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U.S. GOVERNMENT PRINTING OFFICE : 1986 O - 163-041